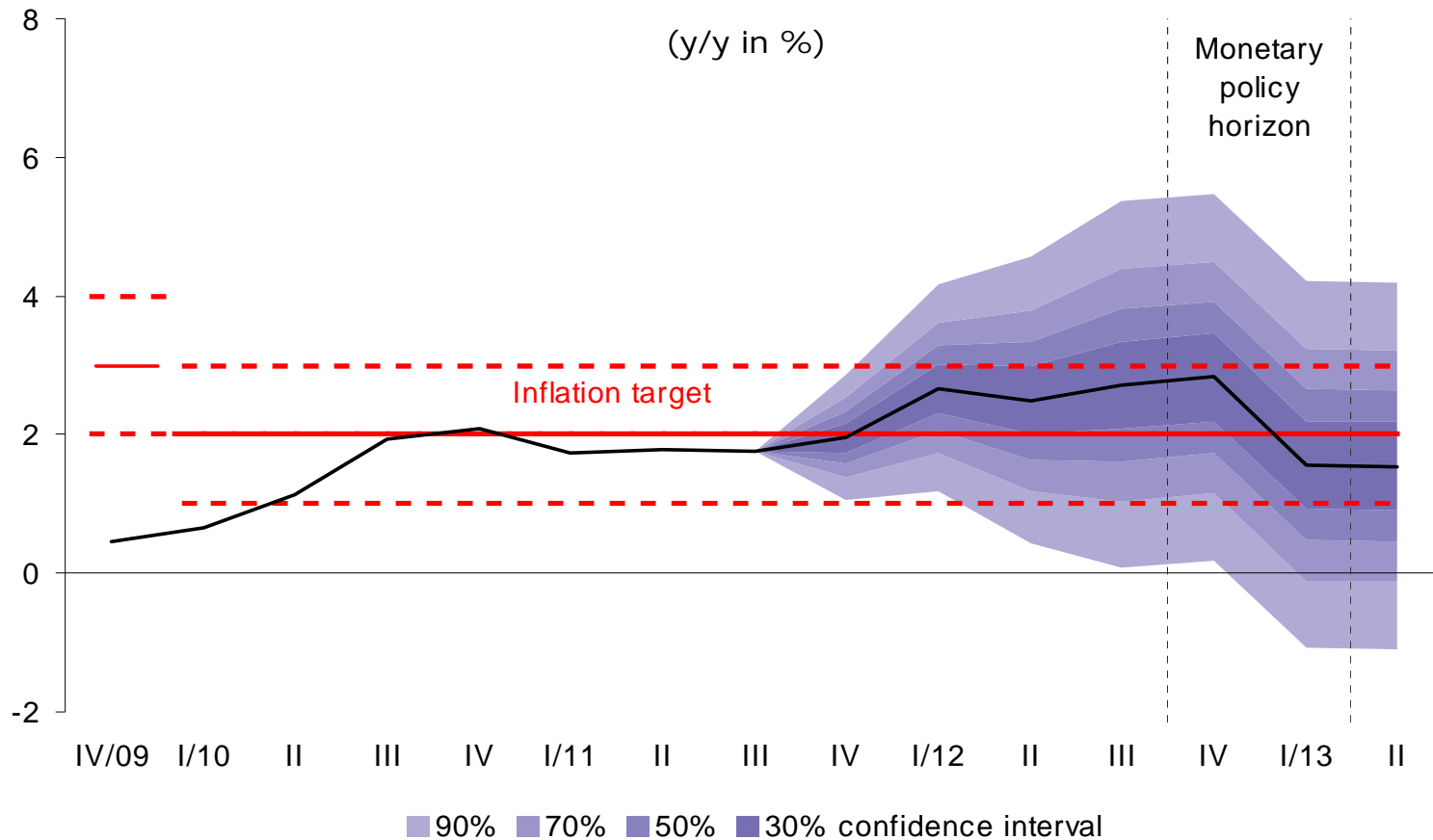


Meeting with Analysts

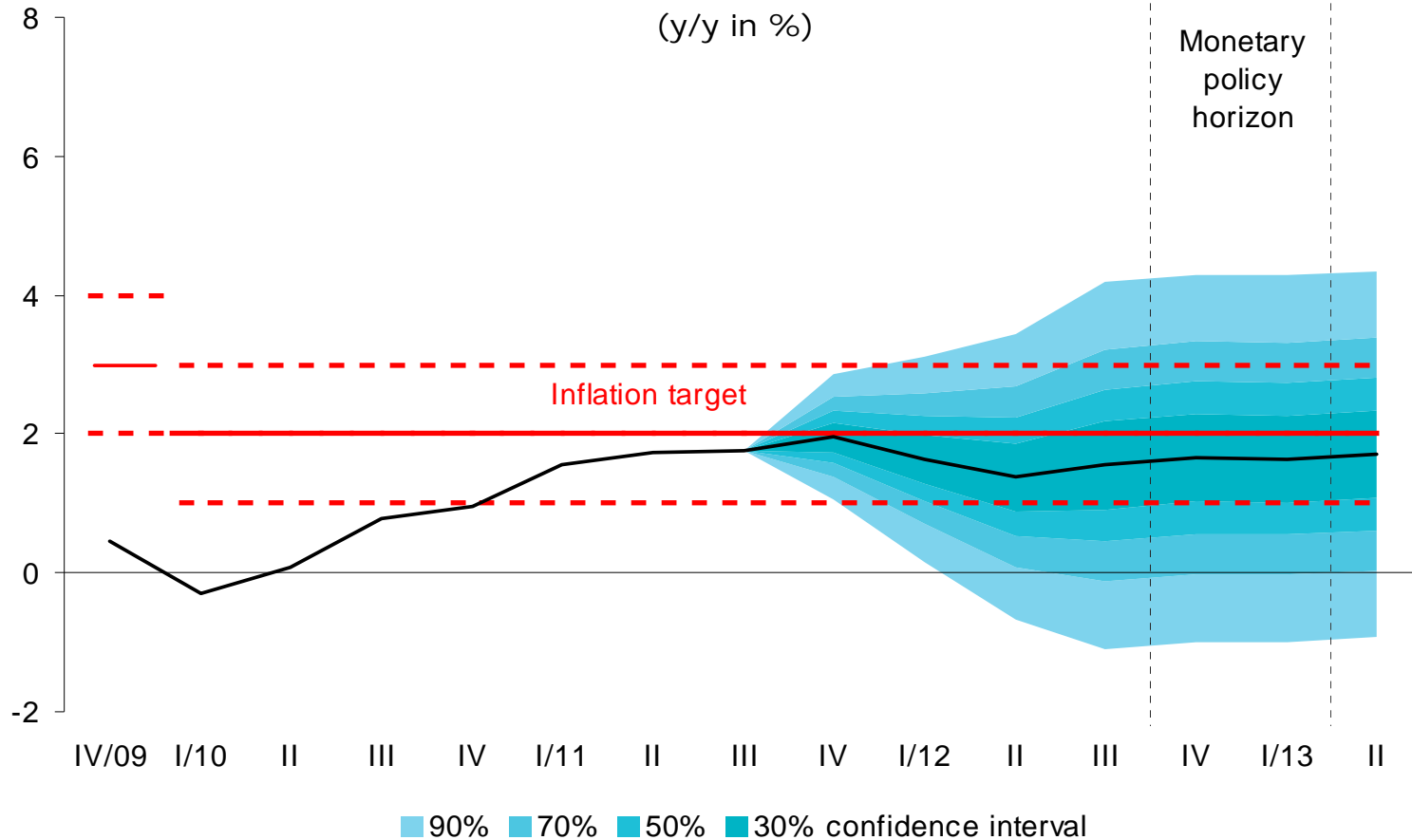
Tomáš Holub

Prague, 11 November 2011

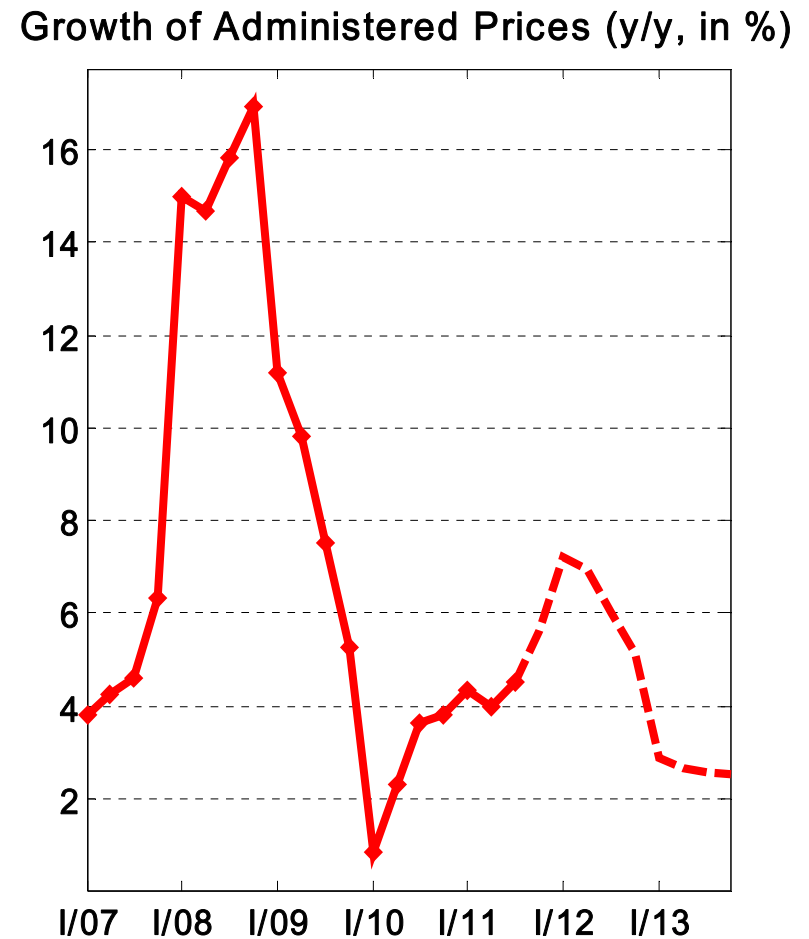
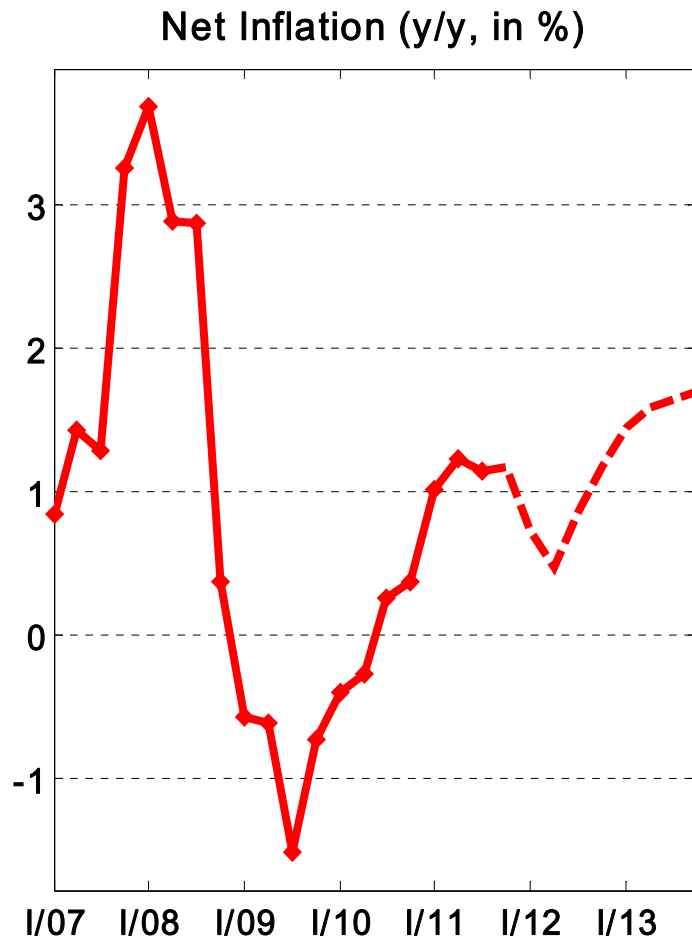
- Headline inflation will rise to just below 3% in 2012 due to the VAT increase, but will decline below the target in early 2013.
- MP-relevant inflation will stay slightly below the 2% target.
- Administered price growth will peak at the beginning of 2012, “net” inflation will decline in the near term.
- Foreign GDP growth will slow. Euro area interest rates will decline and then stay low for a protracted period.
- Commodity prices will cease to be the main source of inflation, the exchange rate appreciation will resume and push import prices back to the anti-inflationary side in 2012.
- Domestic cost pressures are not significant, but will strengthen in the future due to faster wage growth and a slowdown in productivity.
- GDP growth will continue to be affected by fiscal restriction, fading inventory cycle and a decline in external demand growth.



- Inflation will increase somewhat in 2011 Q4 (October: 2.3%).
- In 2012, inflation will temporarily get to just below 3% due to the reduced VAT rate increase from 10% to 14%.
- In 2013, inflation will be below the target.

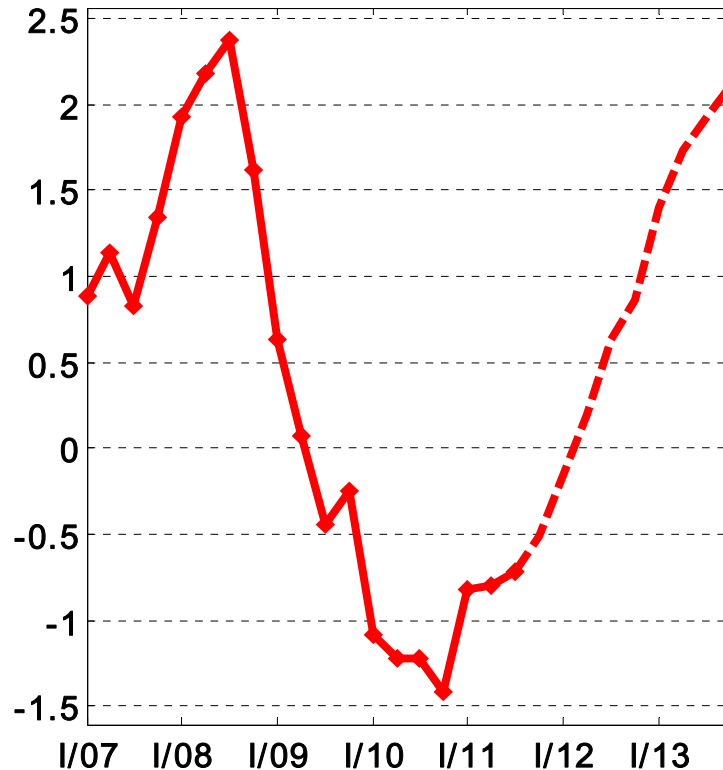


- MP-relevant inflation will remain slightly below the target during the entire forecast horizon.
- Second-round effects of the VAT changes assumed to be small.

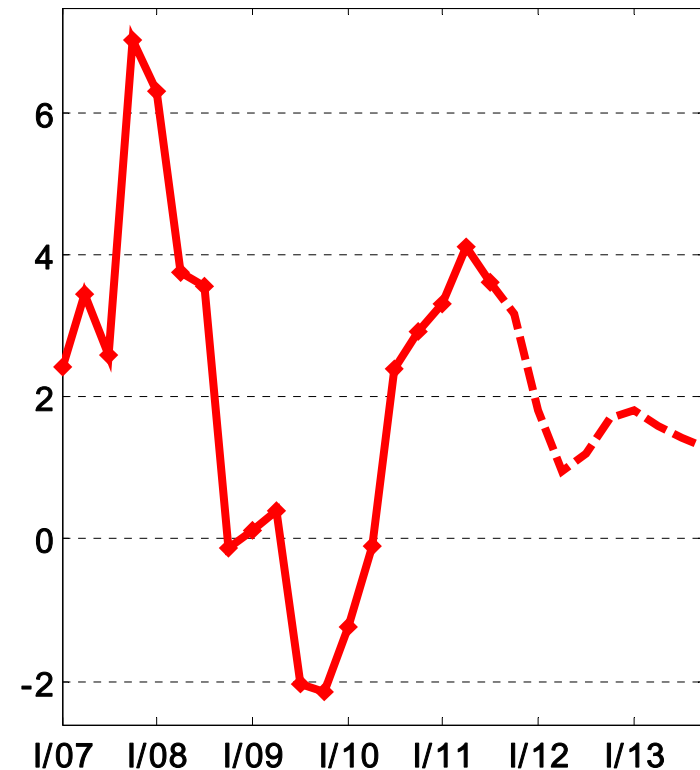


- Net inflation: commodity price shock will fade away (food price growth is already over its peak), while “core” inflation will increase gradually.
- The forecast of administered prices reflects the planned VAT change and the lagged pass-through of past energy price increases.

Adjusted Inflation Excl. Fuels
(y/y, in %, Excl. Tax Changes)

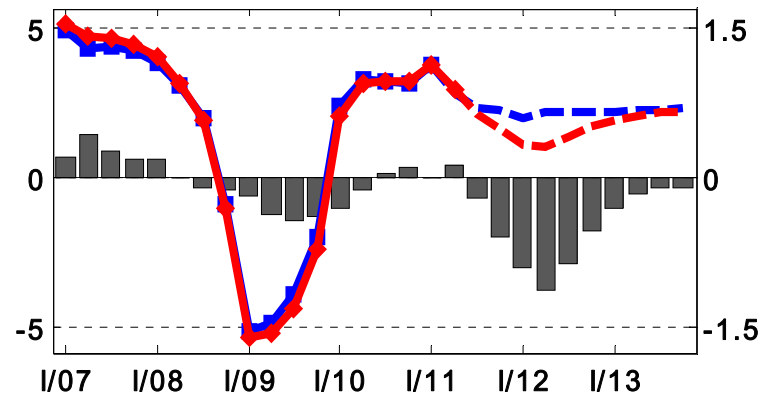


Food Inflation
(y/y, in %, Excl. Tax Changes)

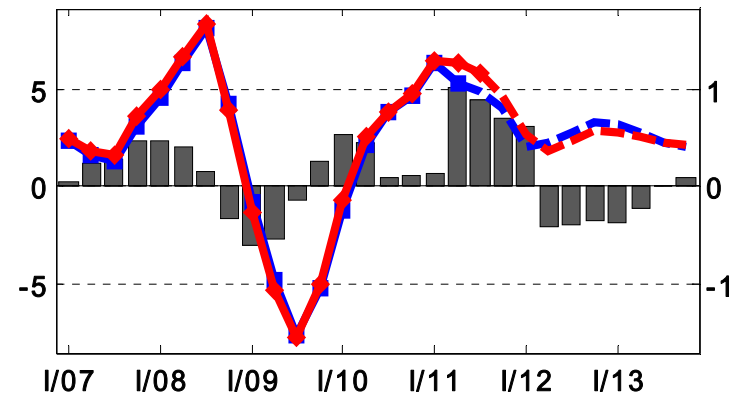


- Adjusted inflation excluding fuels (i.e. "core" inflation) will turn positive in 2012 Q2.
- Food price growth will slow in the near term, reflecting developments in agricultural commodity prices.

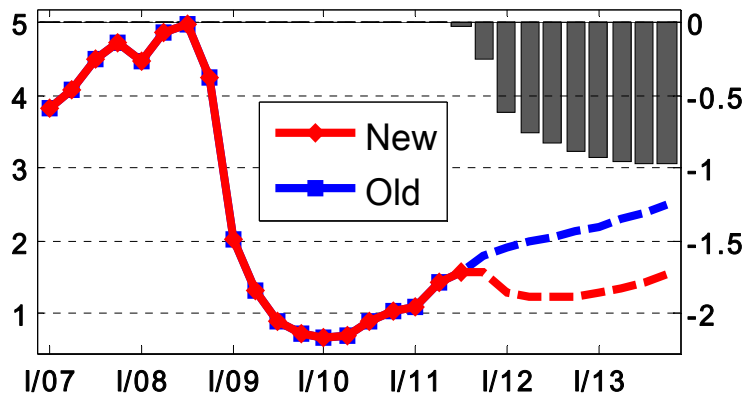
Growth Rate of GDP - Eurozone (y/y, in %)



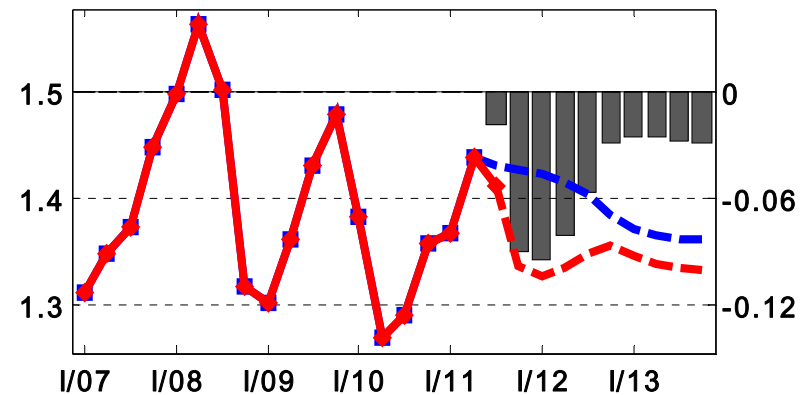
PPI Inflation - Eurozone (y/y, in %)



3M EURIBOR

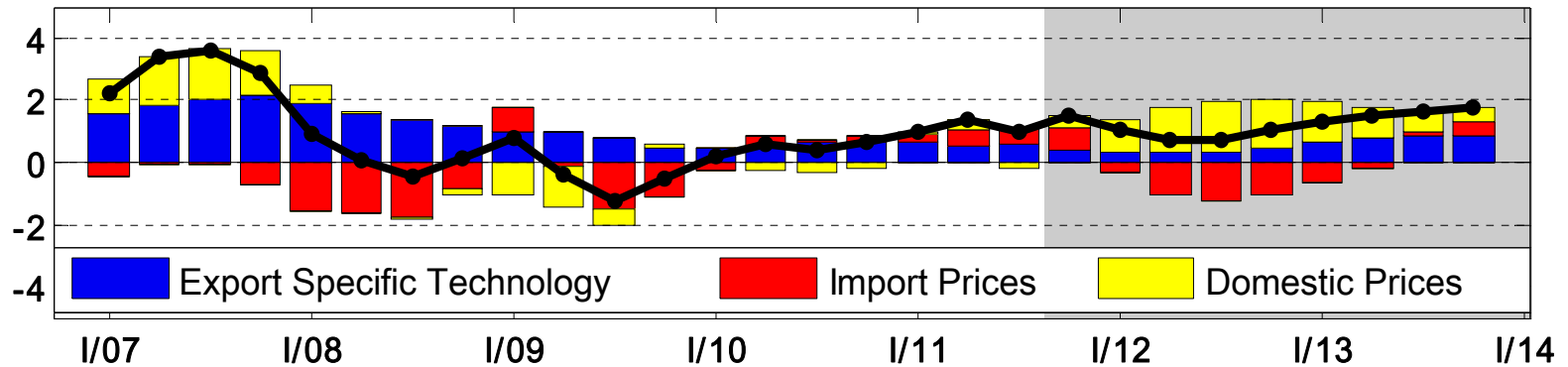


USD/EUR

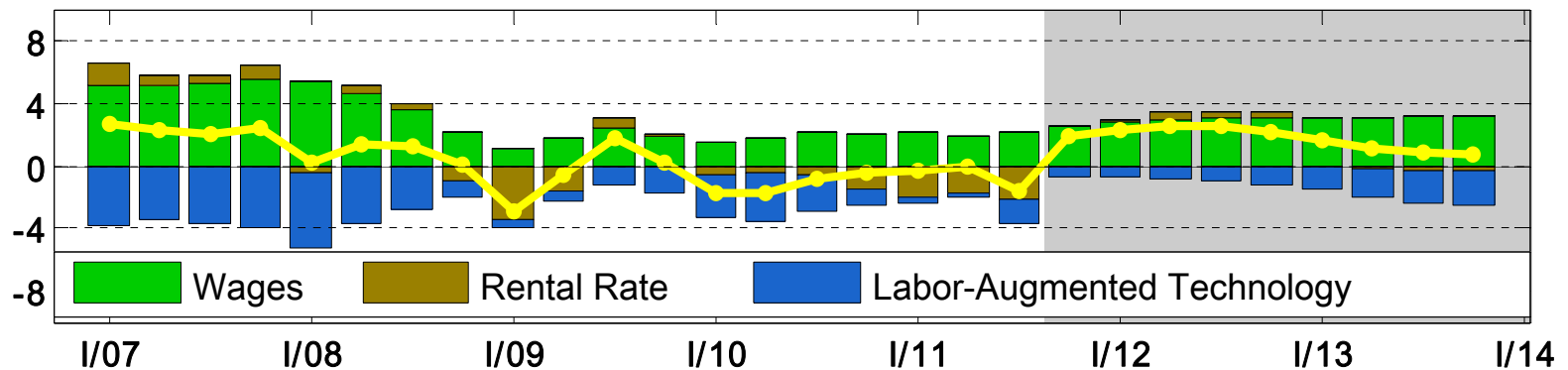


- A (temporary and relatively mild \Rightarrow ?) slowdown in effective GDP growth is expected, reflecting the euro area sovereign debt crisis.
- The crisis has significantly shifted down the **EA** interest rate outlook.

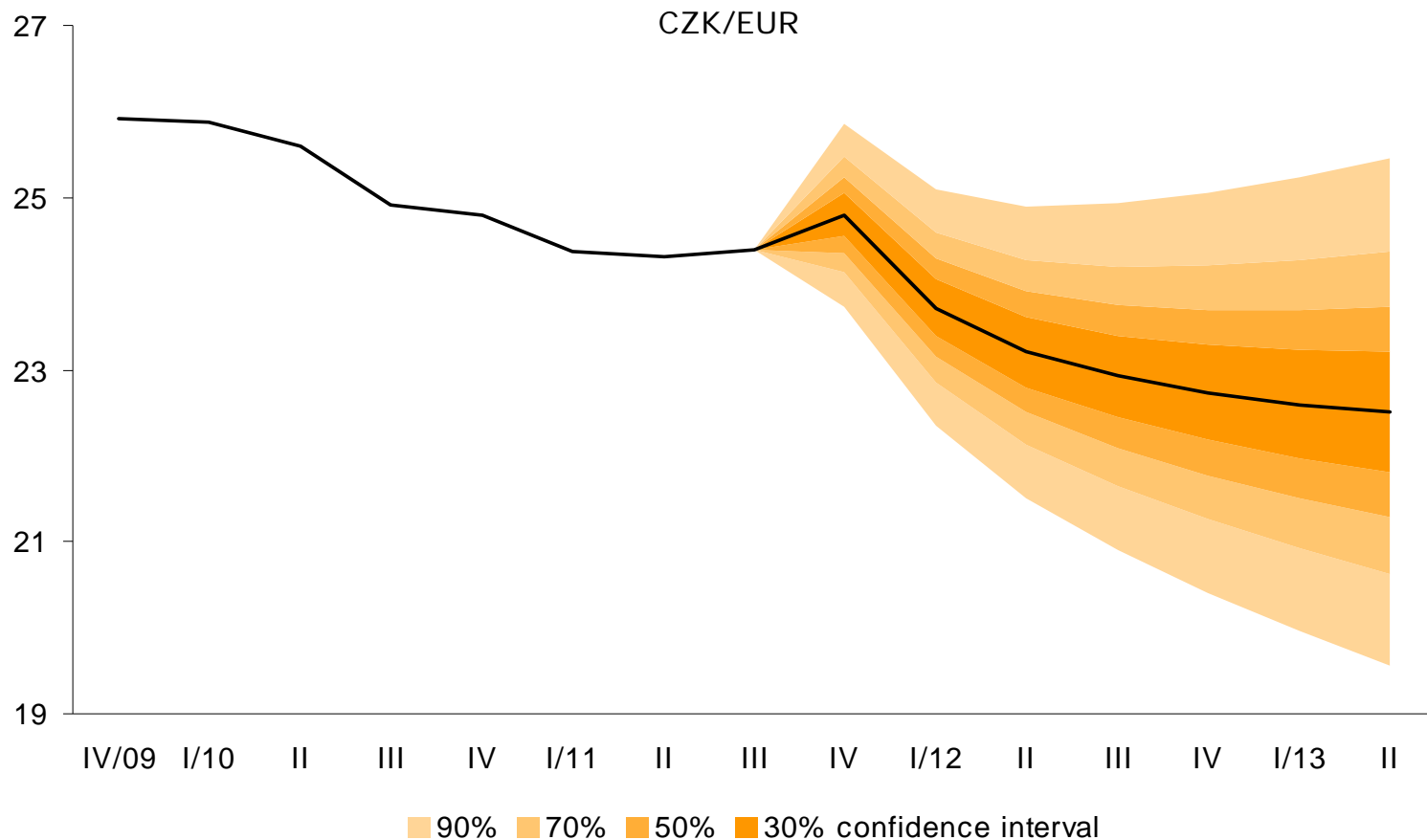
Nominal Marginal Cost in Consumption Sector (q/q, in %, ann.)



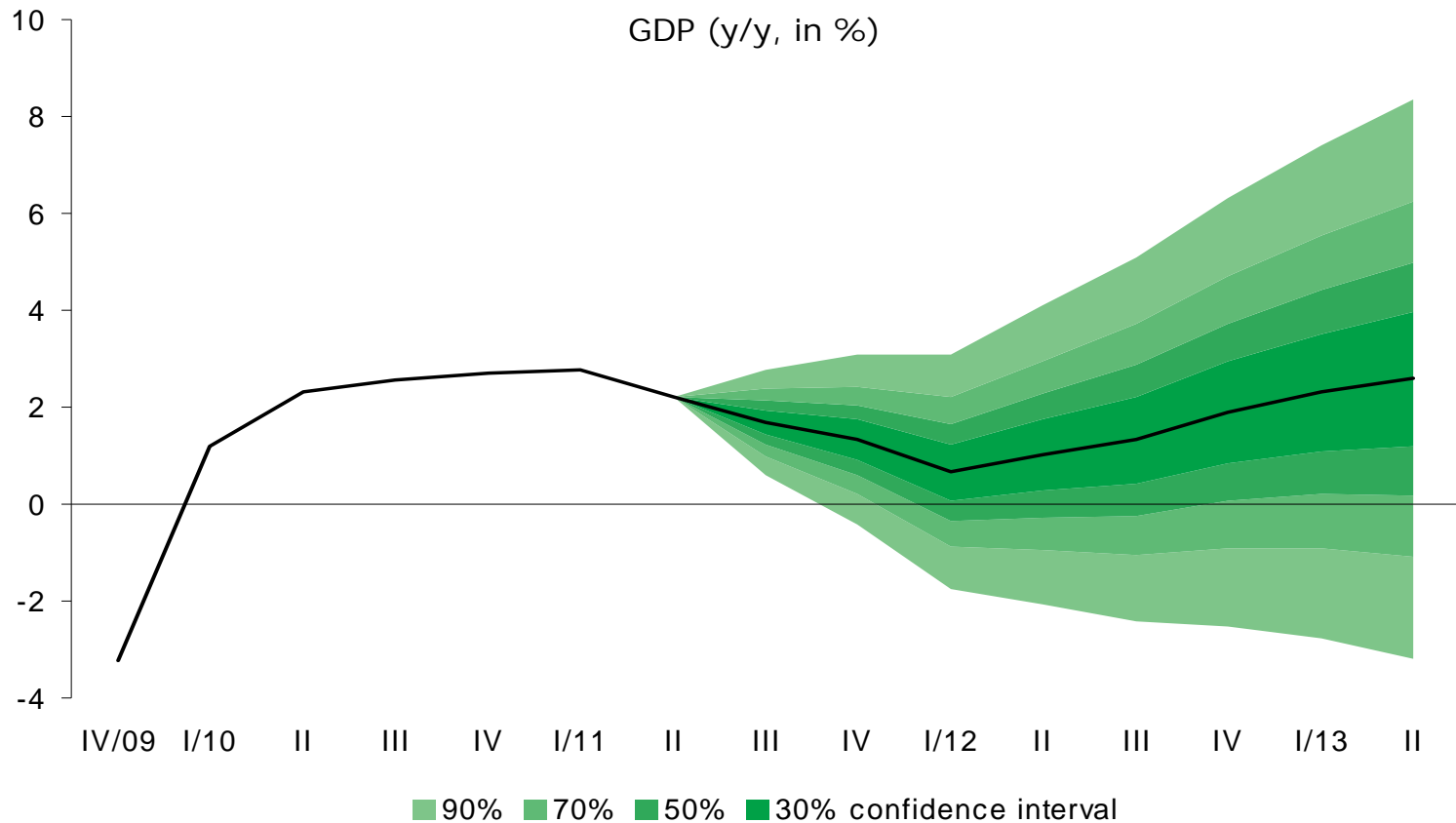
Nominal Marginal Cost in Intermediate Sector (q/q, in %, ann.)



- The current inflationary effect of commodity prices will fade away and a resumed CZK appreciation will push import prices down.
- Domestic cost pressures have not been significant so far (low wage growth), but will strengthen gradually (partly to be absorbed in margins).

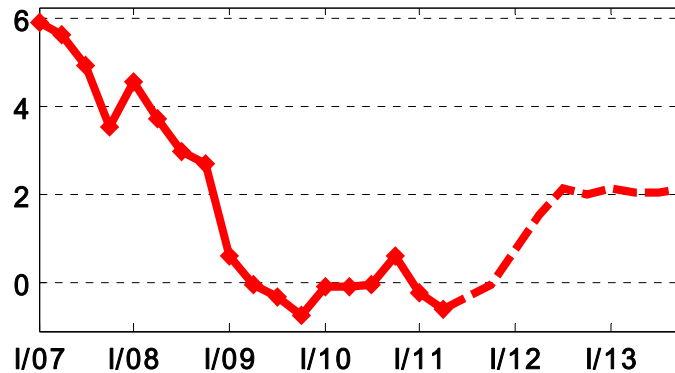


- CZK will resume its appreciation trend due to low foreign interest rates and later on also due to long-term convergence.
- Deterioration of external demand outlook in the CF10 so far not sufficient to offset these forces (see the alternative scenario).

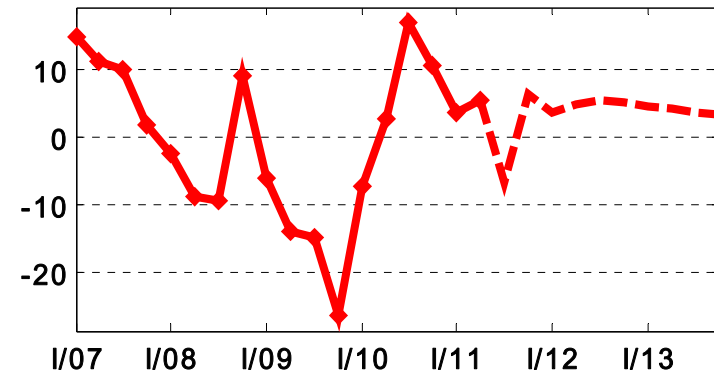


- In 2011, GDP will increase by 2%. The growth will continue to slow due to the weakening of external demand.
- In 2012, the growth will reach 1.2% (external demand slowdown, VAT increase).

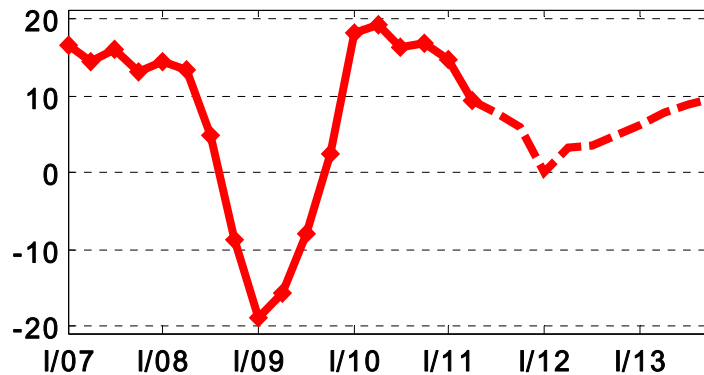
Household Consumption Growth (y/y, in %)



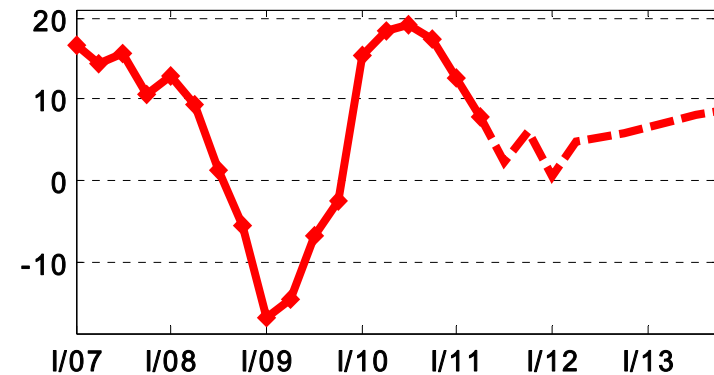
Investments Growth (y/y, in %)



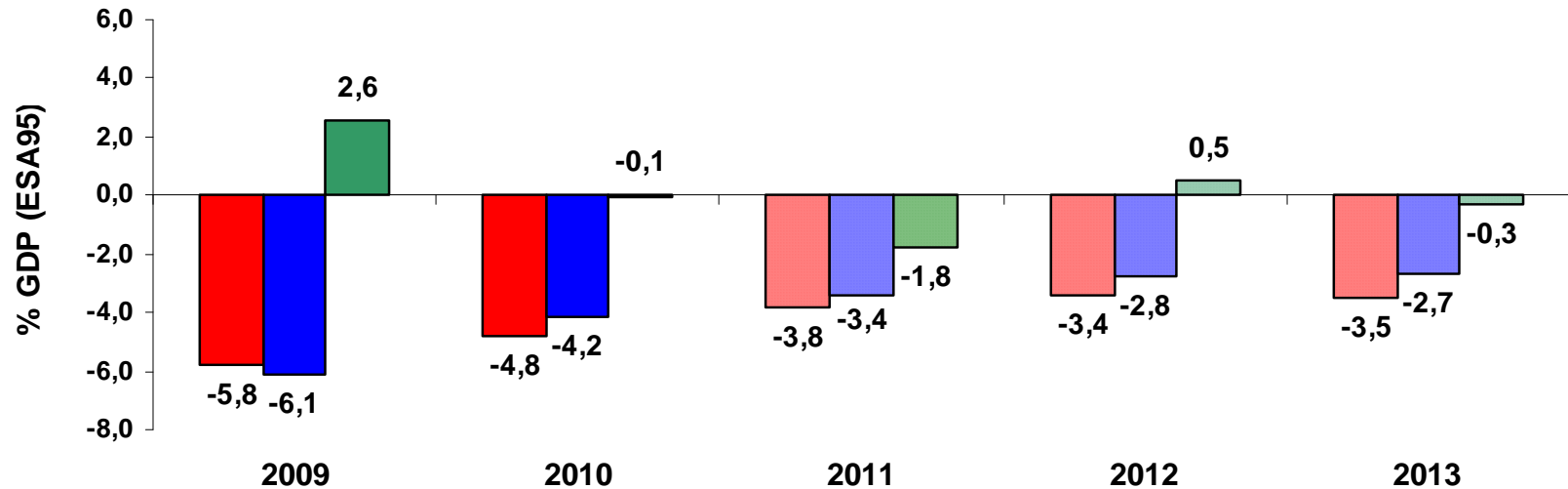
Exports Growth (y/y, in %)



Imports Growth (y/y, in %)



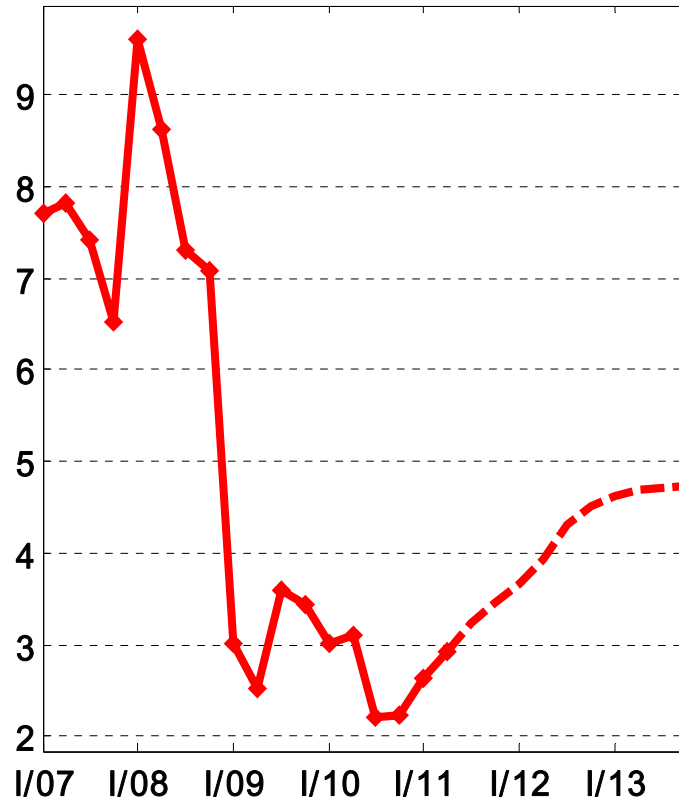
- Private consumption growth will start to accelerate, but its pace will be moderated by the still weak labour market and the VAT change.
- Export growth will decline significantly in late 2011/early 2012 due to slower external demand growth; negative NX contribution in 2012.¹¹



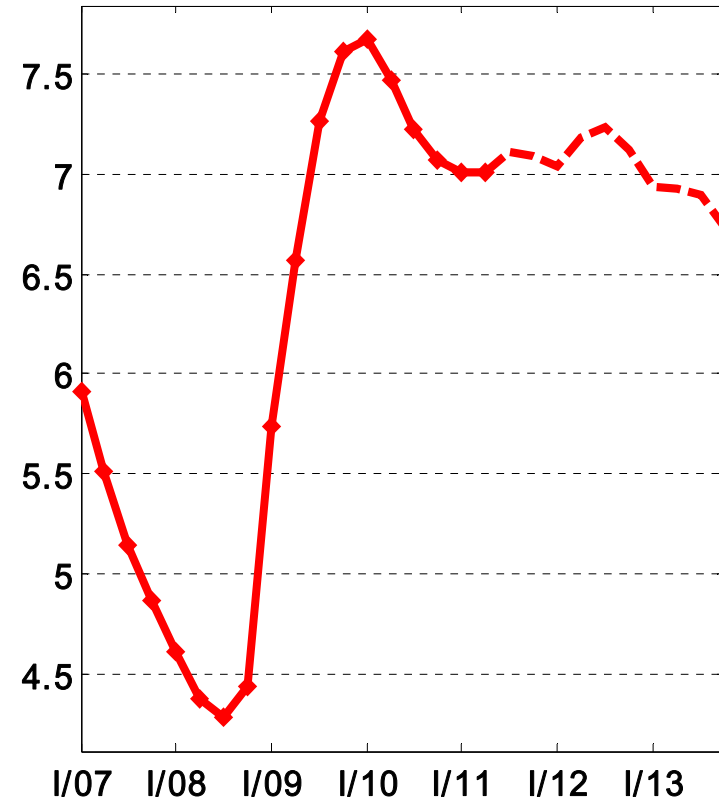
■ Public budget deficit ■ Structural deficit (ESCB) ■ Real government consumption (y-o-y %)

- In 2011, the public budget deficit will decline to less than 4% of GDP due to the adopted consolidation measures.
- In 2012, a further decline to 3.4% of GDP will result mainly from the reduced VAT rate increase from 10% to 14%.
- In 2013, a slight worsening of the deficit-to-GDP ratio will reflect the business cycle and pension reform (revenues down by CZK 15 bn).

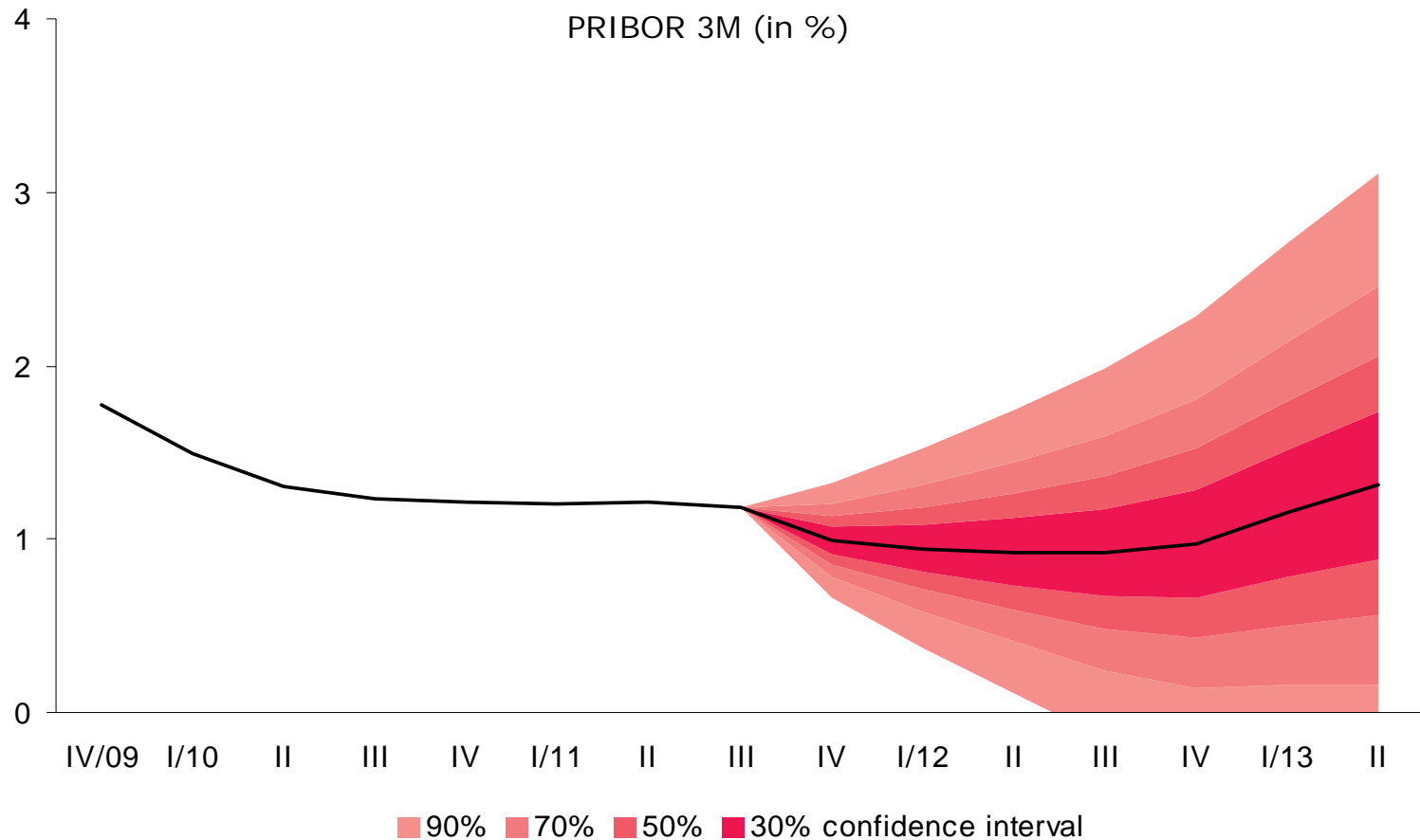
Nominal wage growth in business sector
(y/y, in %, s.a.)



General unemployment rate (ILO)
(in %, s.a.)

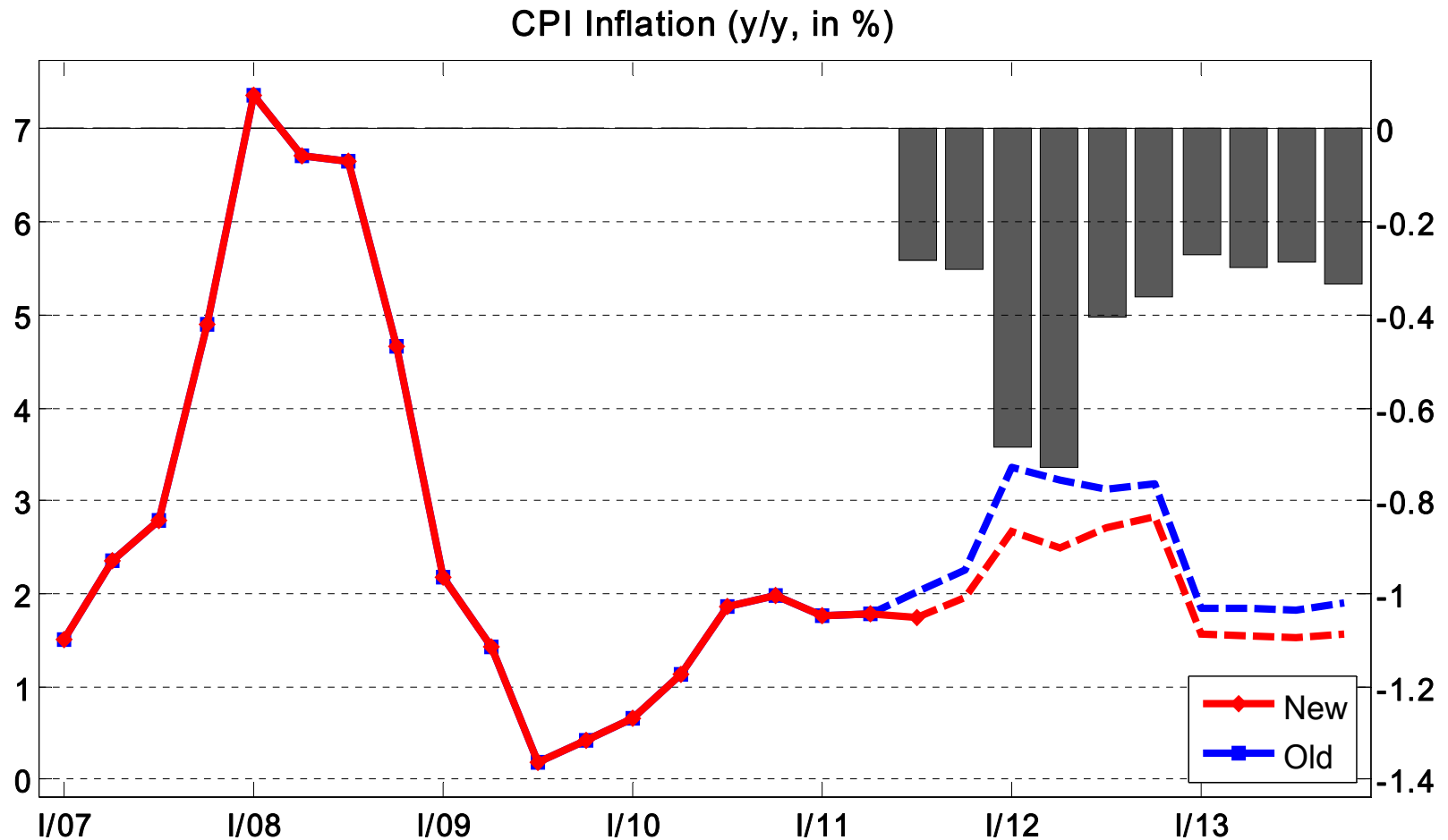


- Wage growth will accelerate gradually from the current low level.
- Employment growth will halt temporarily, and the unemployment rate will start to decrease only in 2013.

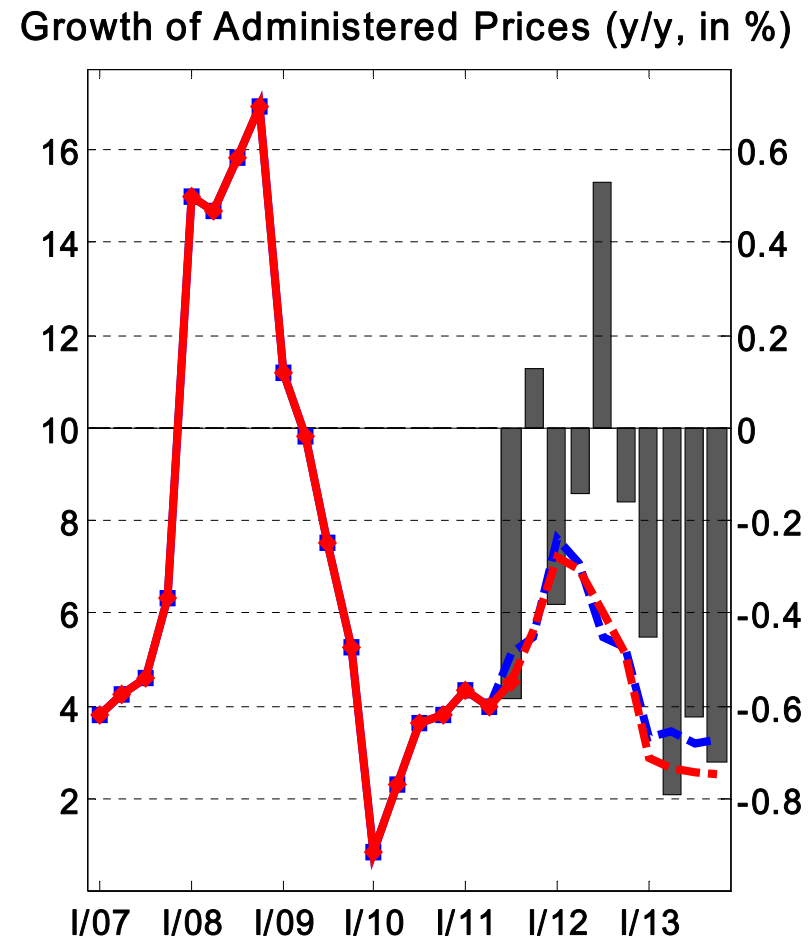
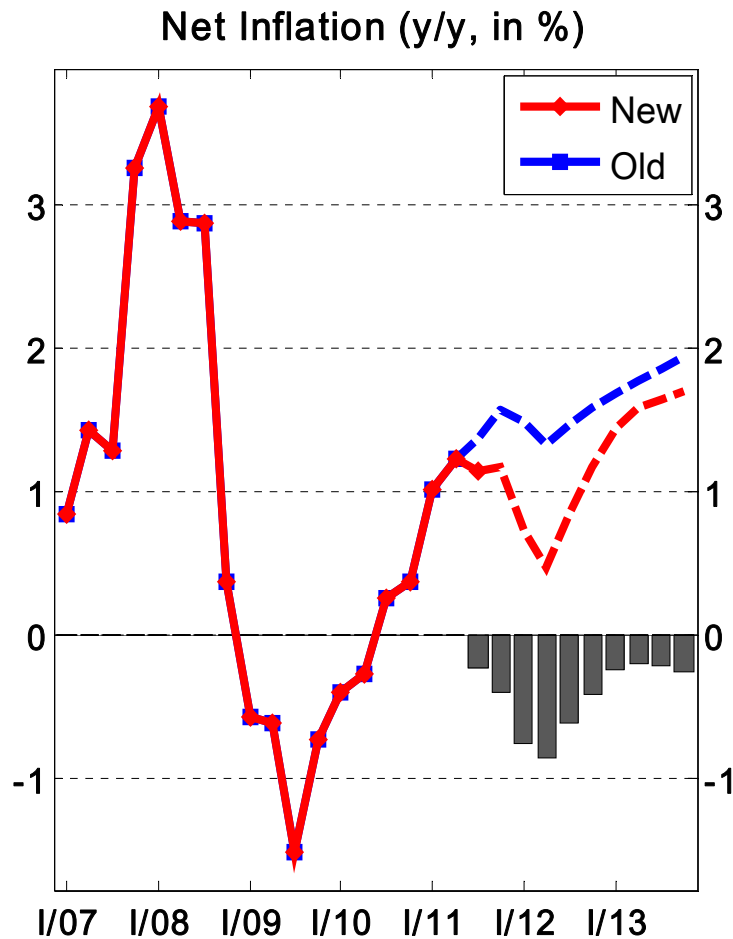


- Consistent with the forecast is a slight decline in market interest rates at the start of the forecast and flat rates until late 2012/early 2013.
- Low interest rates reflect low rates in the euro area and the absence of domestic inflationary pressures.

- The forecast of headline inflation has been reduced.
- The lower headline inflation forecast reflects lower administered price growth, as well as lower net inflation.
- The slightly lower net inflation forecast in 2012 is due to a decreased forecast both for food prices and “core” inflation.
- GDP growth forecast has been lowered significantly.
- The labour market forecast reflects the weaker growth outlook.
- The exchange rate is initially weaker, but returns quickly to the original path (due to the lower EURIBOR).
- The interest rate path is considerably lower due mainly to the downward shift in foreign interest rate outlook.

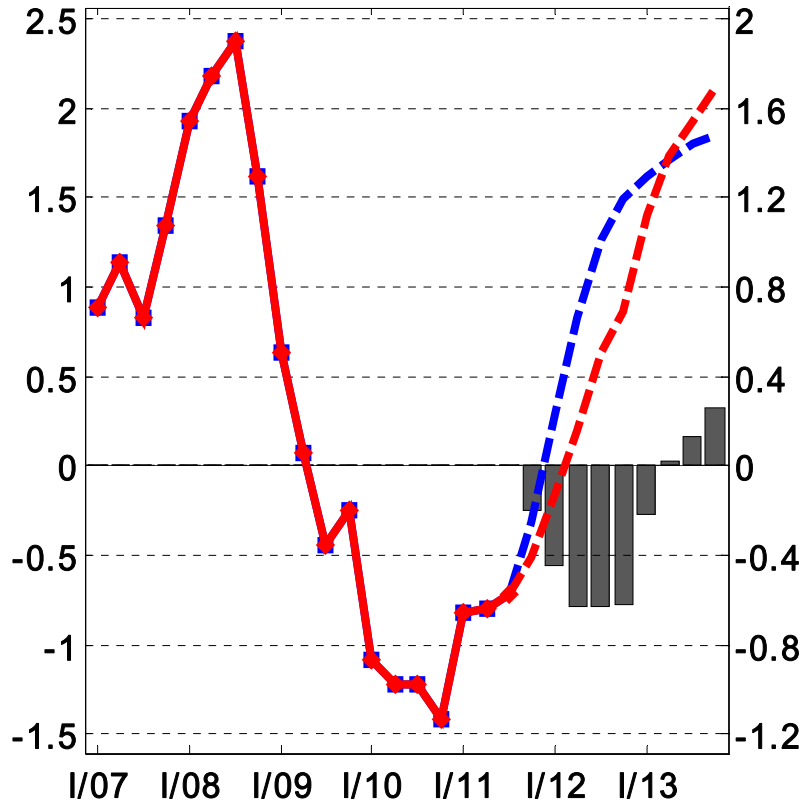


- The headline (as well as MP-relevant) inflation forecast has been lowered for the entire forecast horizon.

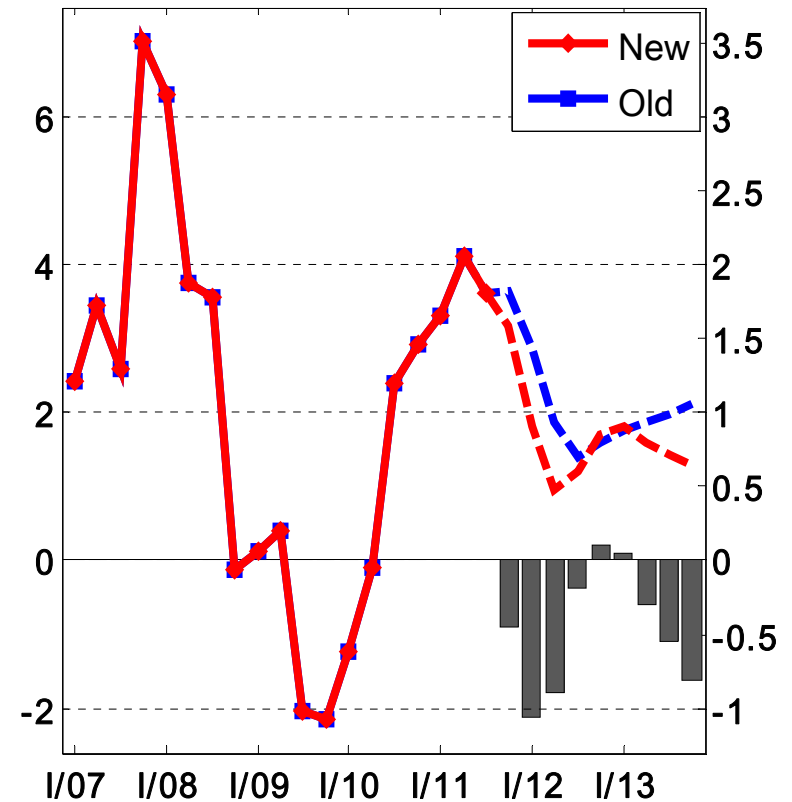


- Net inflation forecast is lower, above all in 2012.
- Administered price growth reflects slightly lower outlook for commodity prices (natural gas) and assumed slower growth in rents.

Adjusted Inflation Excl. Fuels
(y/y, in %, Excl. Tax Changes)

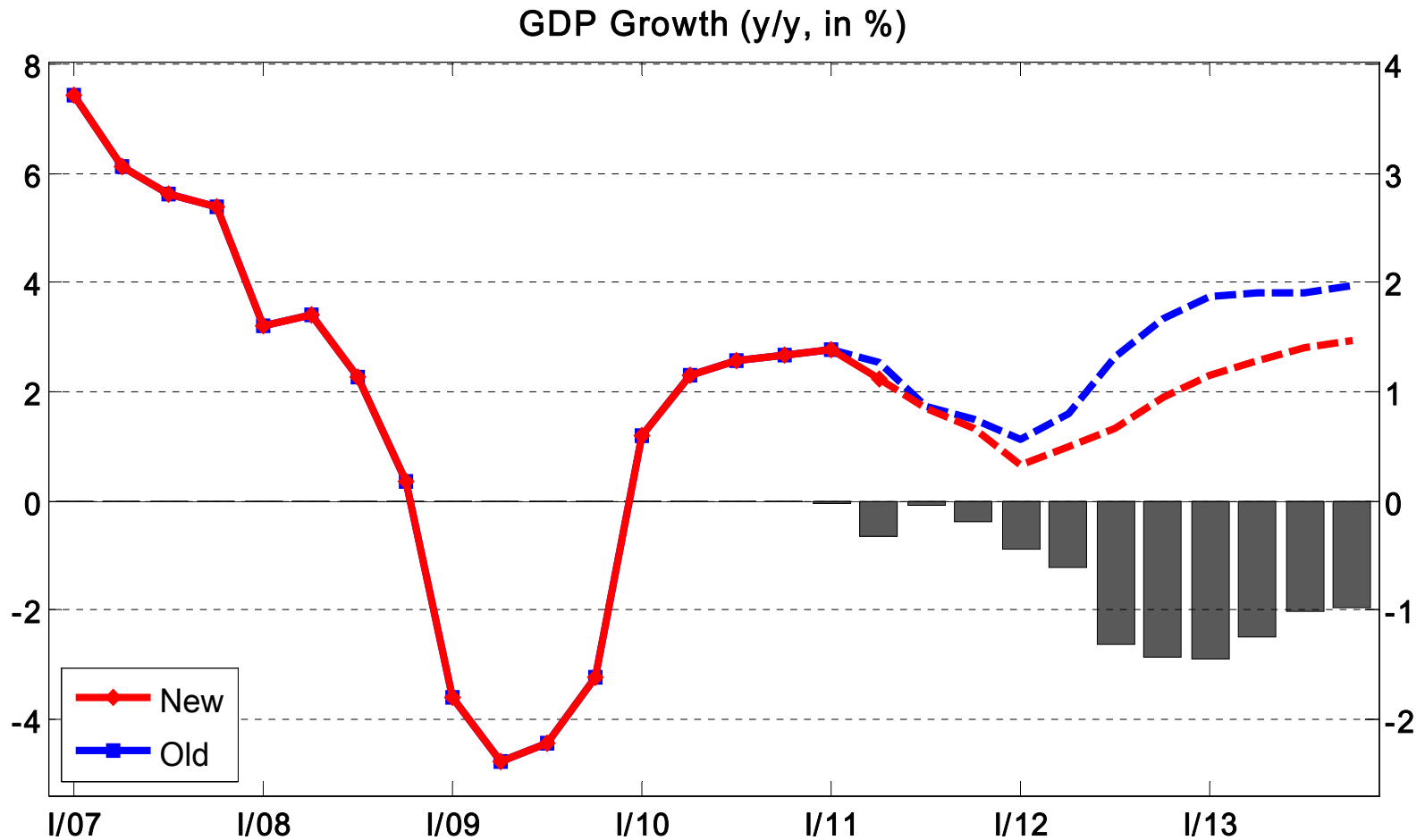


Food Inflation
(y/y, in %, Excl. Tax Changes)



- The forecast of adjusted inflation excluding fuels is lower due to the economic slowdown and the fast return of CZK to an appreciation trend.
- Food price growth reflects lower agricultural prices.

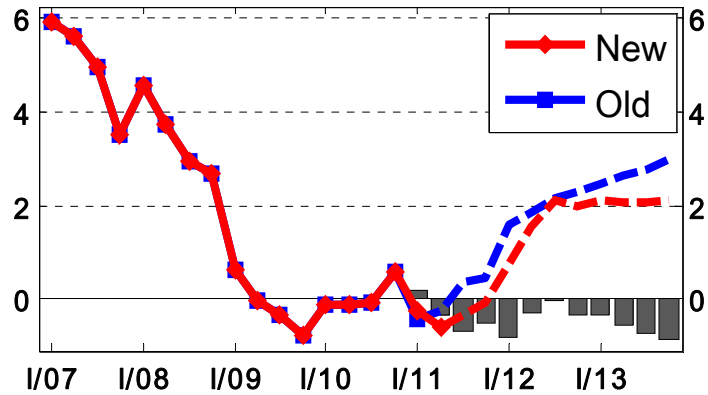
Comparison with Previous GDP Forecast (i)



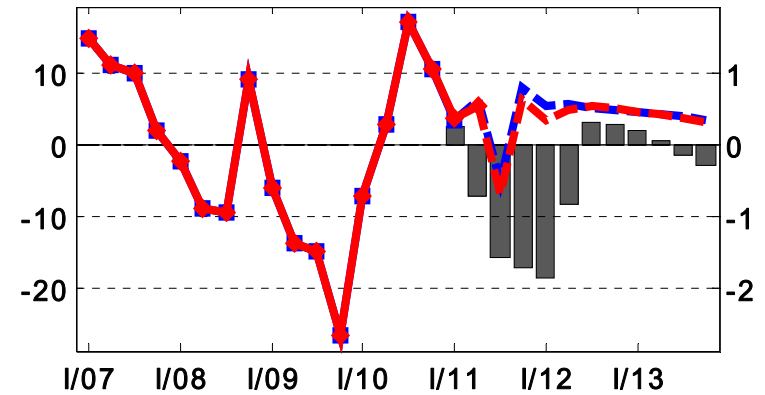
- Lower forecast mainly due to weaker foreign growth outlook, partly also due to the 2011 Q2 outcome.

Comparison with Previous GDP Forecast (ii)

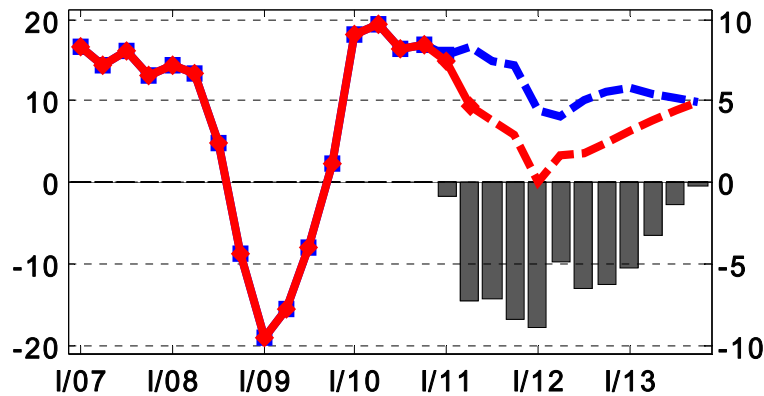
Household Consumption Growth (y/y, in %)



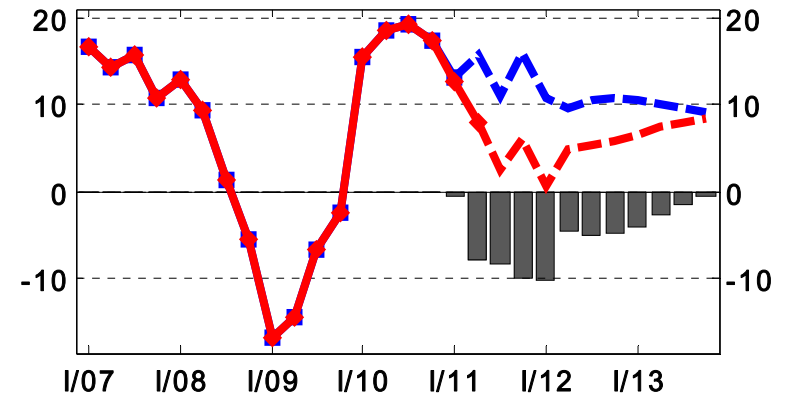
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)

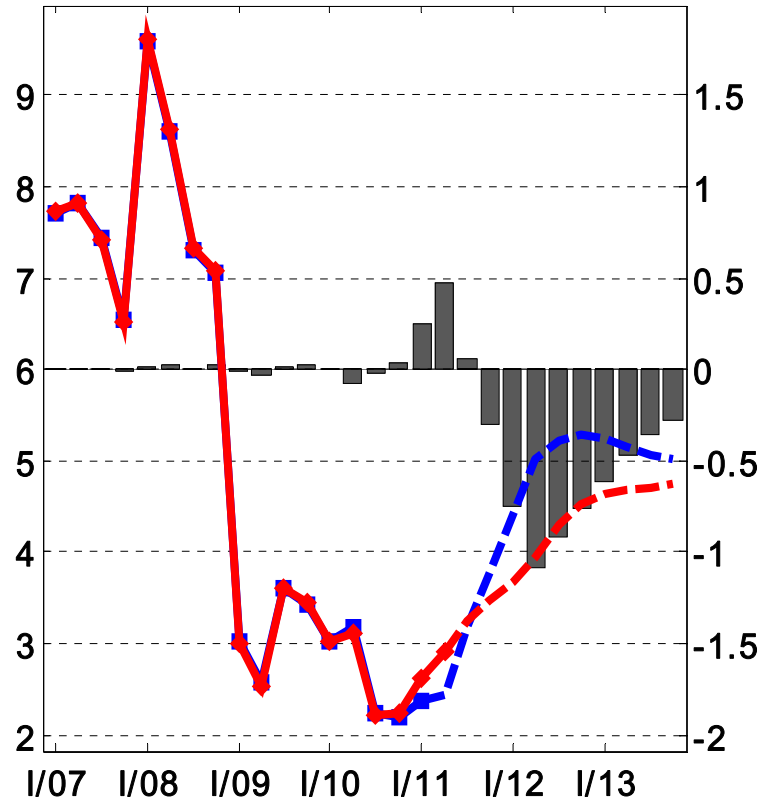


Imports Growth (y/y, in %)

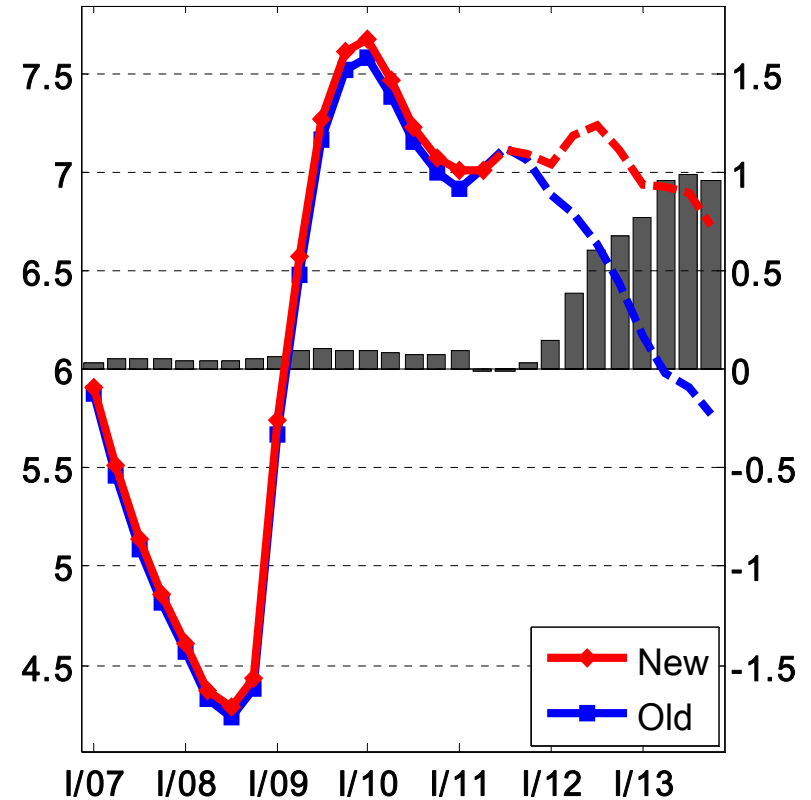


- Much more muted growth in both exports and imports in 2012.
- Slower consumption growth in 2012 due to weaker wage growth.

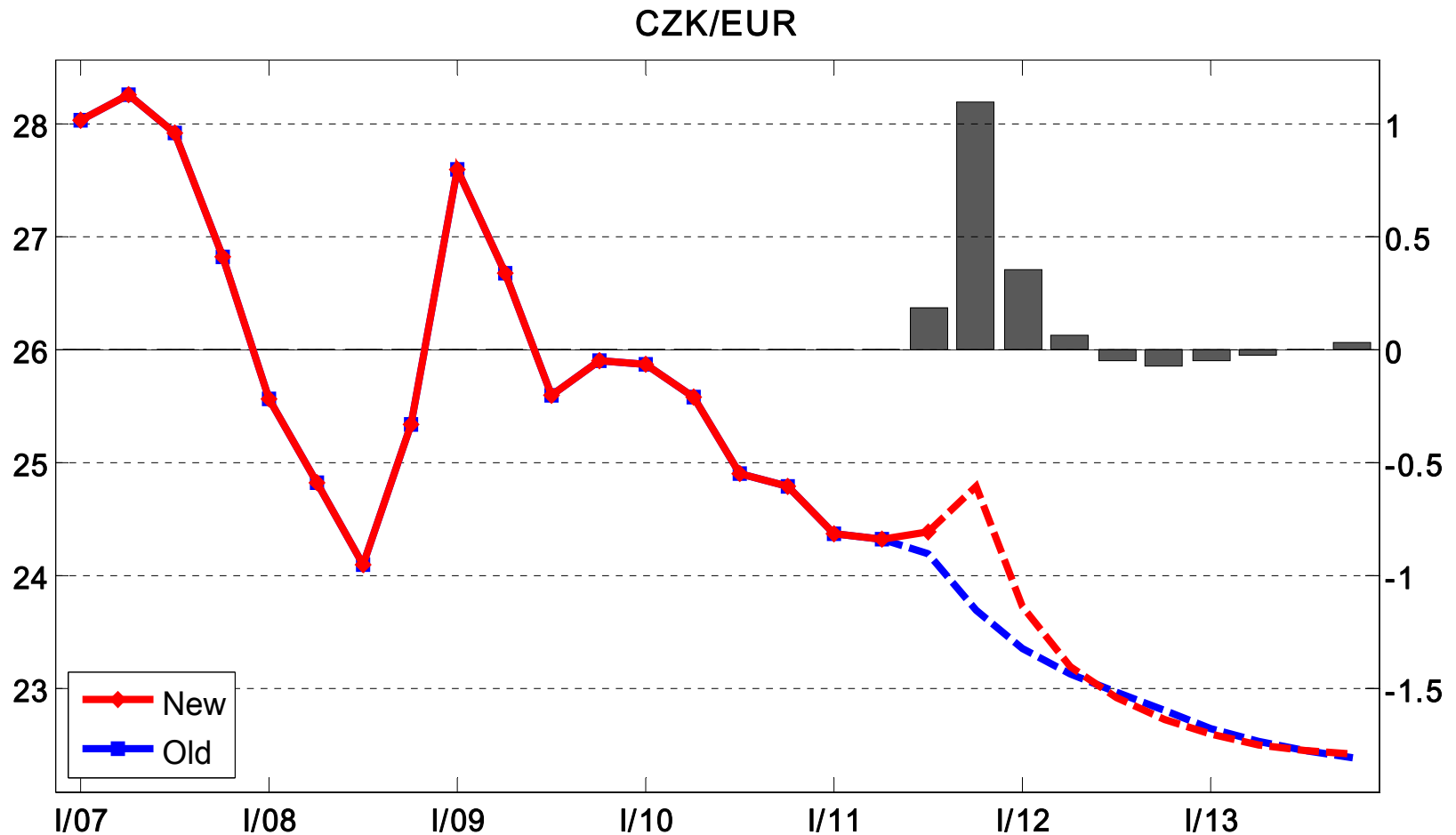
Nominal wage growth in business sector
(y/y, in %, s.a.)



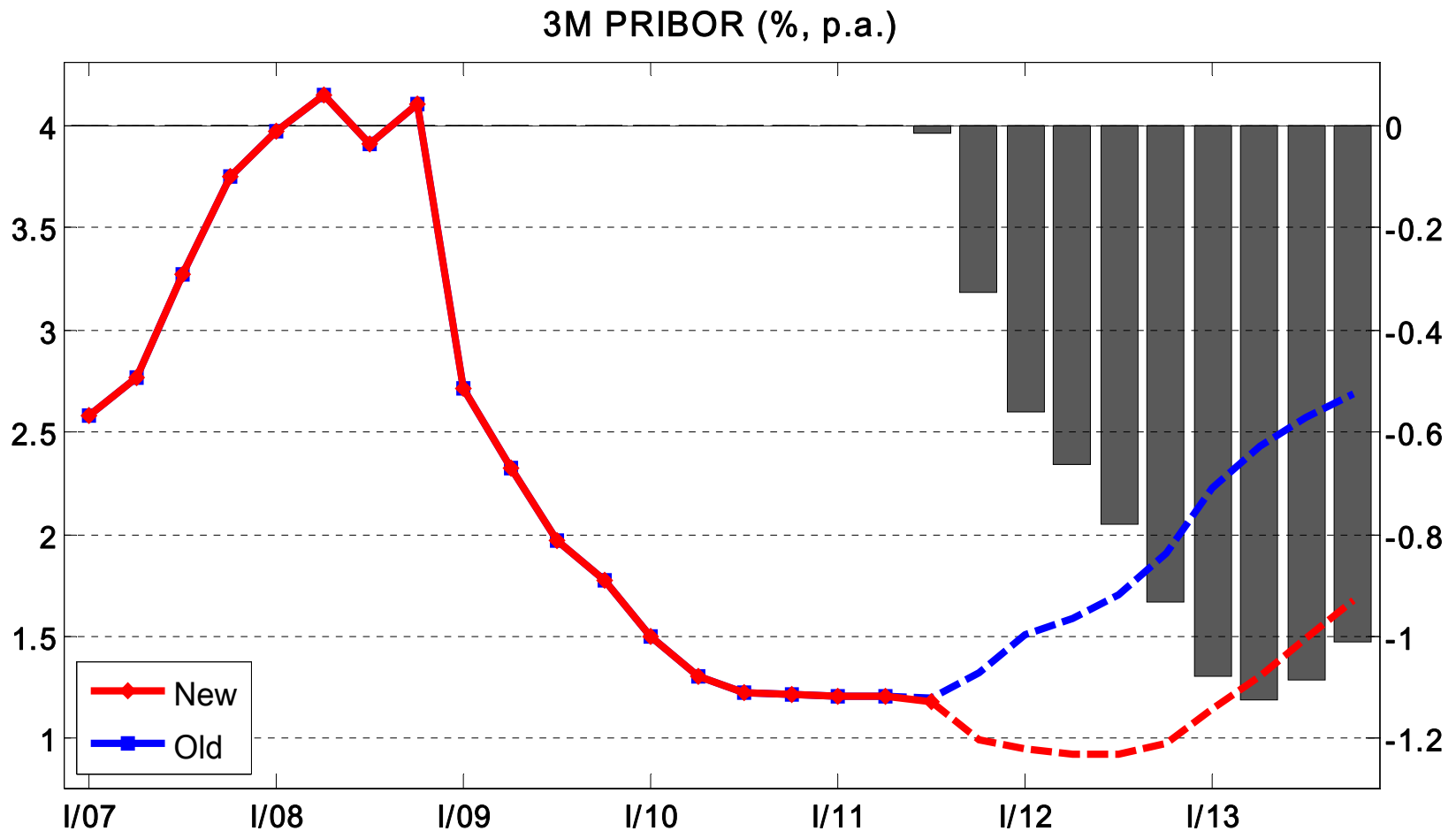
General unemployment rate (ILO)
(in %, s.a.)



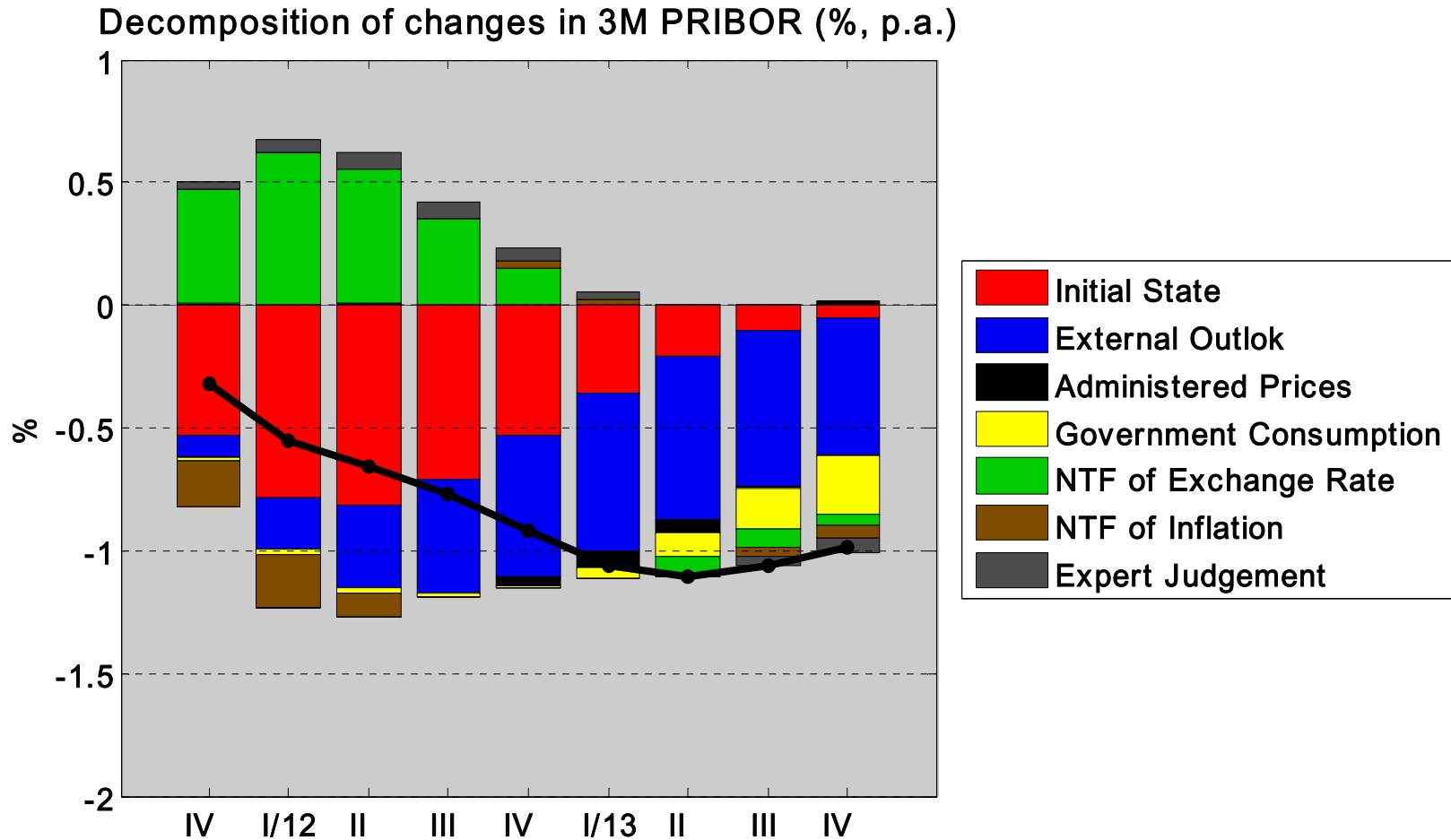
- The labour market forecast reflects the expected more pronounced slowdown in economic growth.



- Weaker exchange rate initially due to the escalation of euro area debt crisis, but then a fast return to the previous forecast caused by the lower foreign interest rate outlook.

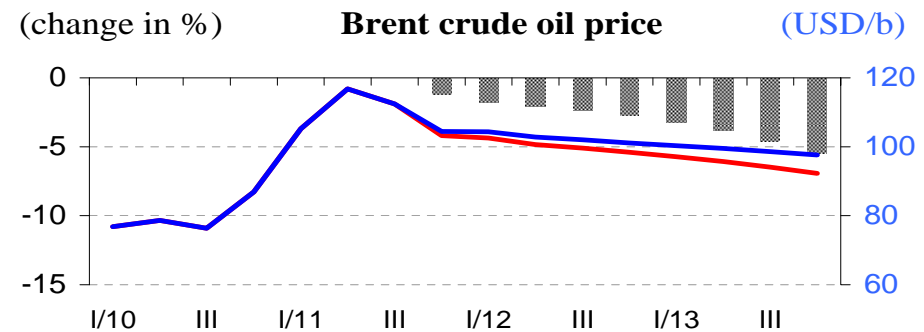
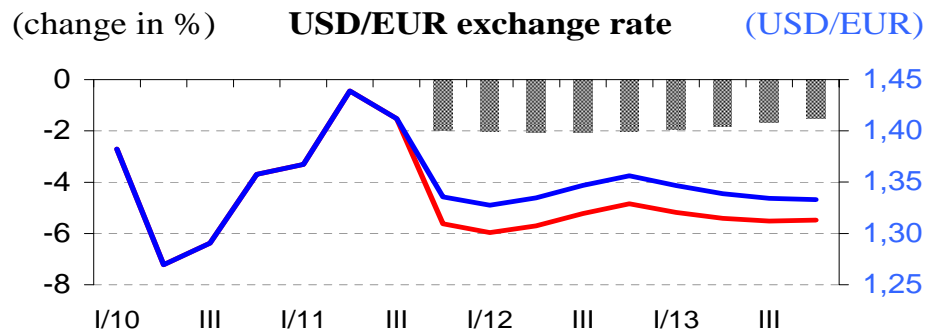
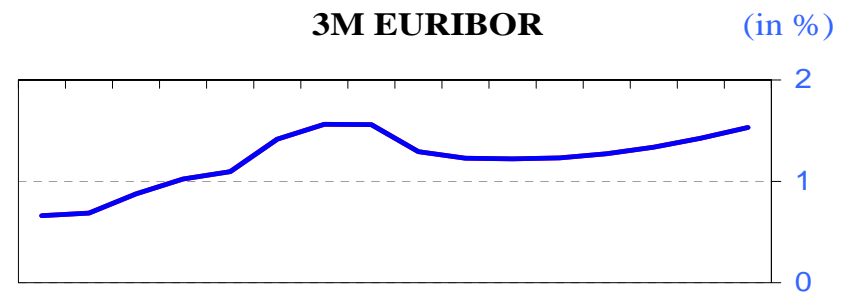
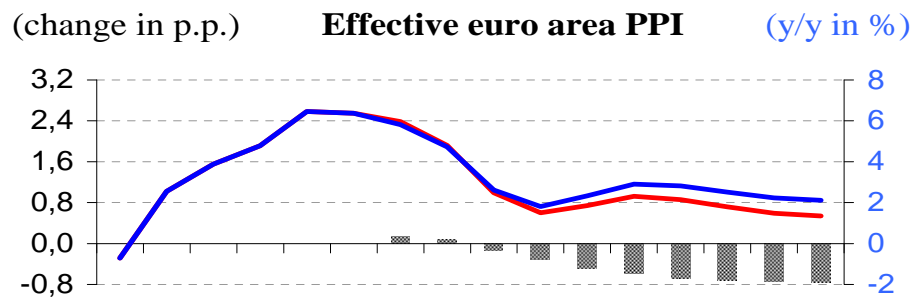
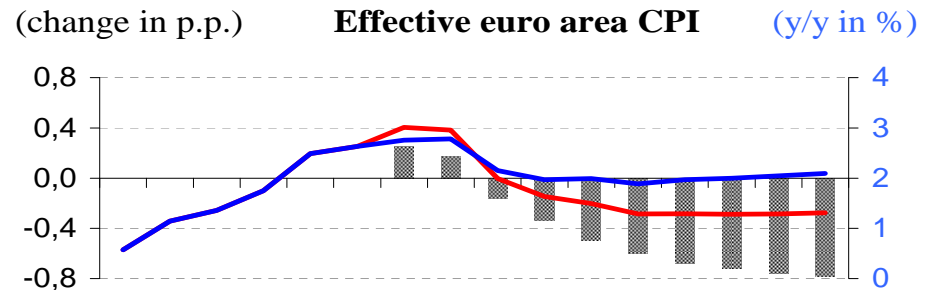
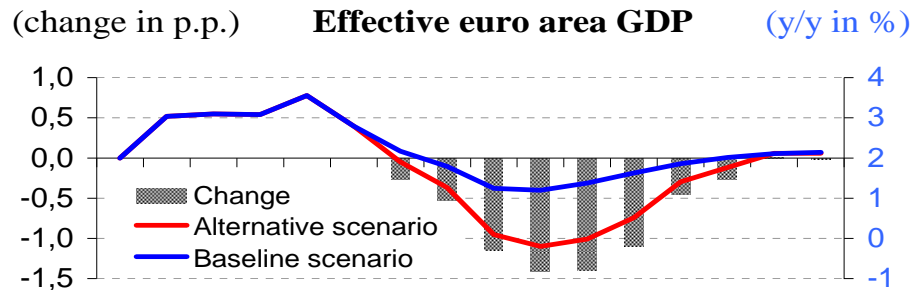


- The forecast for domestic money market interest rates is considerably lower over the entire forecast horizon.

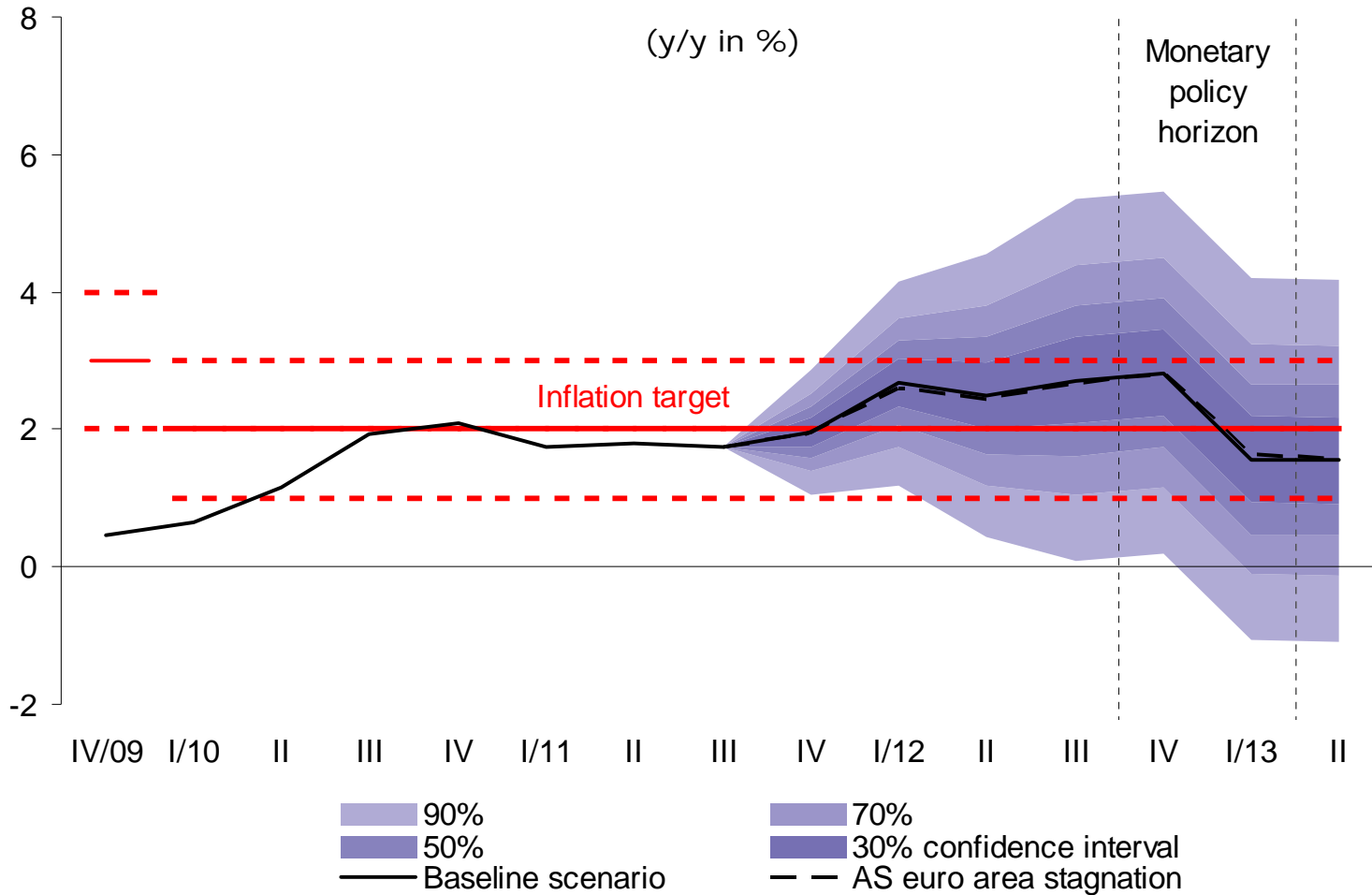


- The downward pressure of the new external economic outlook (mainly lower EURIBOR) and the initial state is only partly offset by an upward effect of the near-term exchange rate forecast.

- **motivation**: potential inconsistency in the outlook for external variables; different speeds of reflecting the escalation of the euro area debt crisis (slow for the economic activity and inflation outlook from the CF – recall the 2008 experience after the collapse of LB; fast as regards market yield curves).
- **baseline scenario**: as of 10 October, CF analysts expected a temporary and relatively mild slowdown in euro area GDP growth in 2012 vs. the low market outlook for 3M EURIBOR.
- **alternative scenario**: simulation of an outlook for foreign variables which corresponds to the current market outlook for 3M EURIBOR, using the NiGEM model.

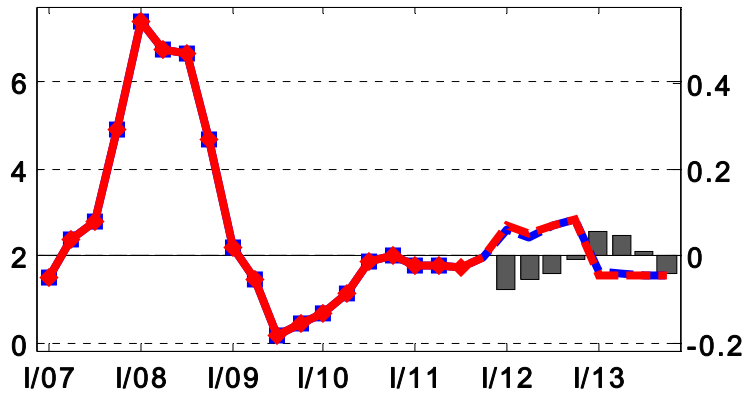


- Much more pronounced and protracted slowdown in economic activity in the alternative scenario (euro area stagnation in 2012).
- Faster disinflation, weaker euro and lower global energy prices.

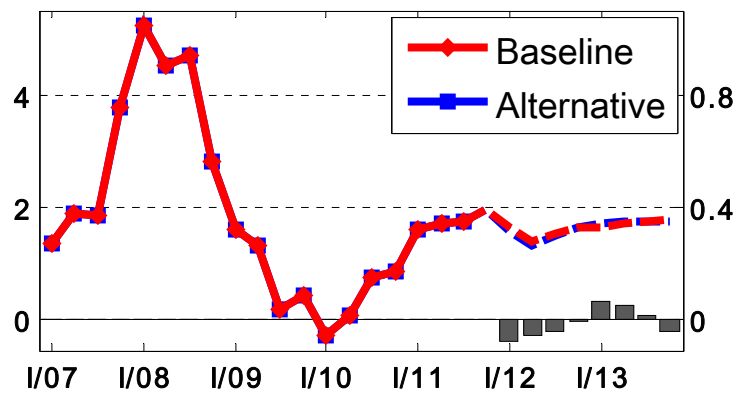


- Negligible difference for the headline inflation forecast.
- Slower GDP and wage growth, lower regulated prices vs. weaker exchange rate path.

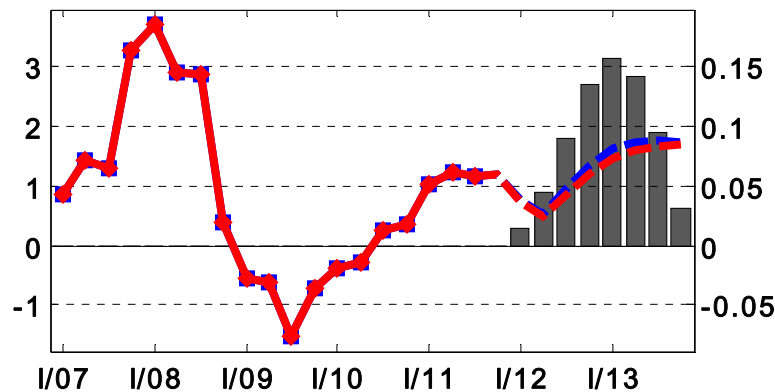
CPI Inflation (y/y, in %)



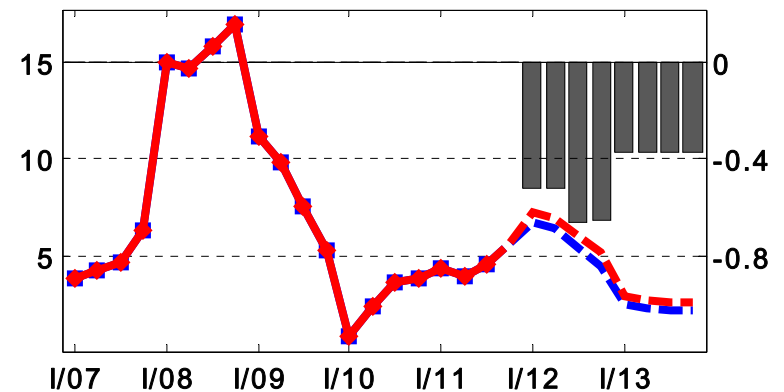
MP Inflation (y/y, in %)



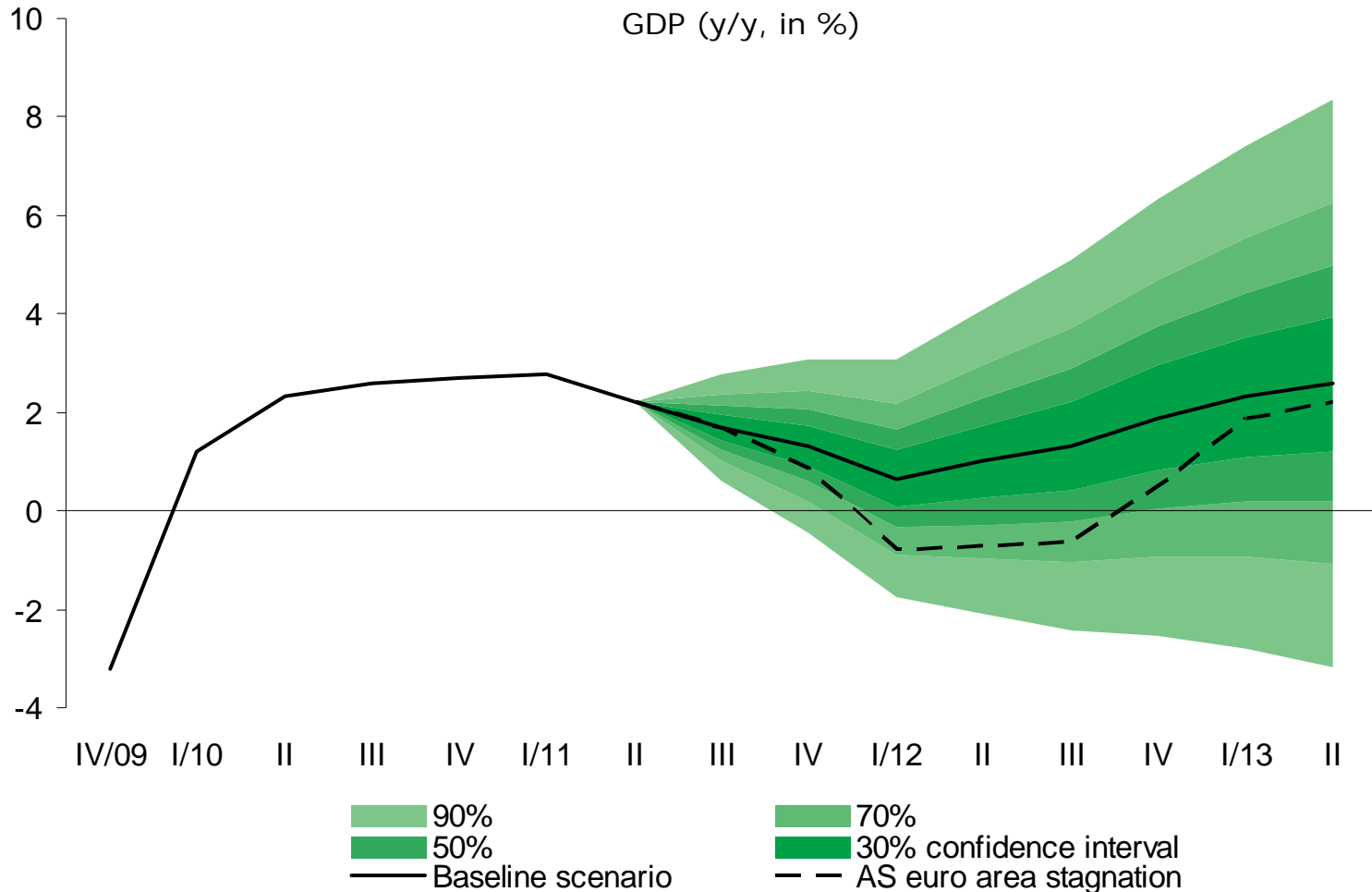
Net Inflation (y/y, in %)



Growth of Administered Prices (y/y, in %)

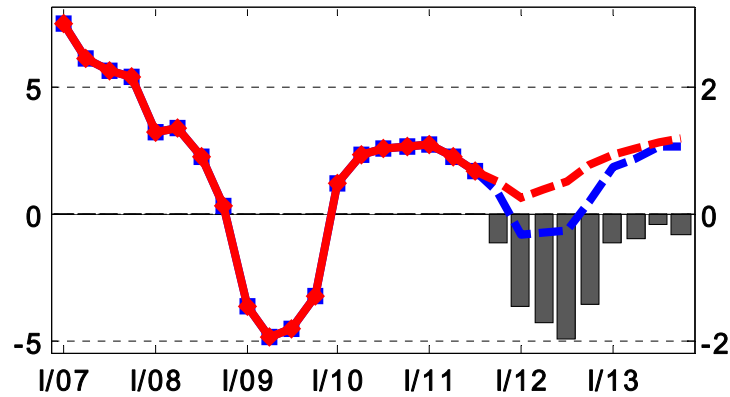


- Slightly higher net inflation (the exchange rate impact is dominant) vs. more muted administered price growth (lower commodity prices).

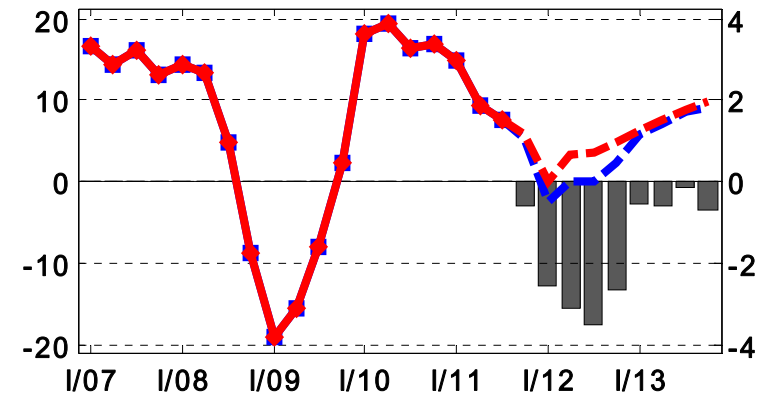


- The more adverse outlook for external demand has a straightforward reflection in the Czech GDP forecast.
- Weaker exchange rate playing an offsetting role only partially.

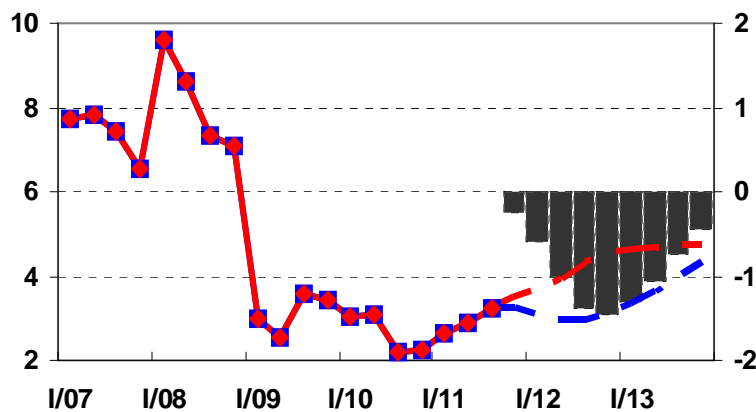
GDP Growth (y/y, in %)



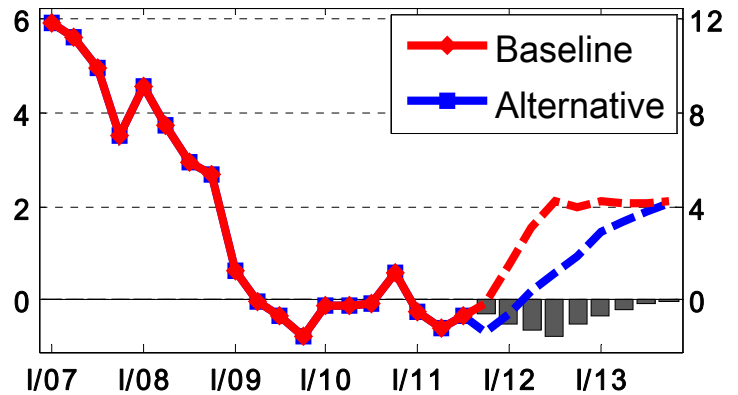
Exports Growth (y/y, in %)



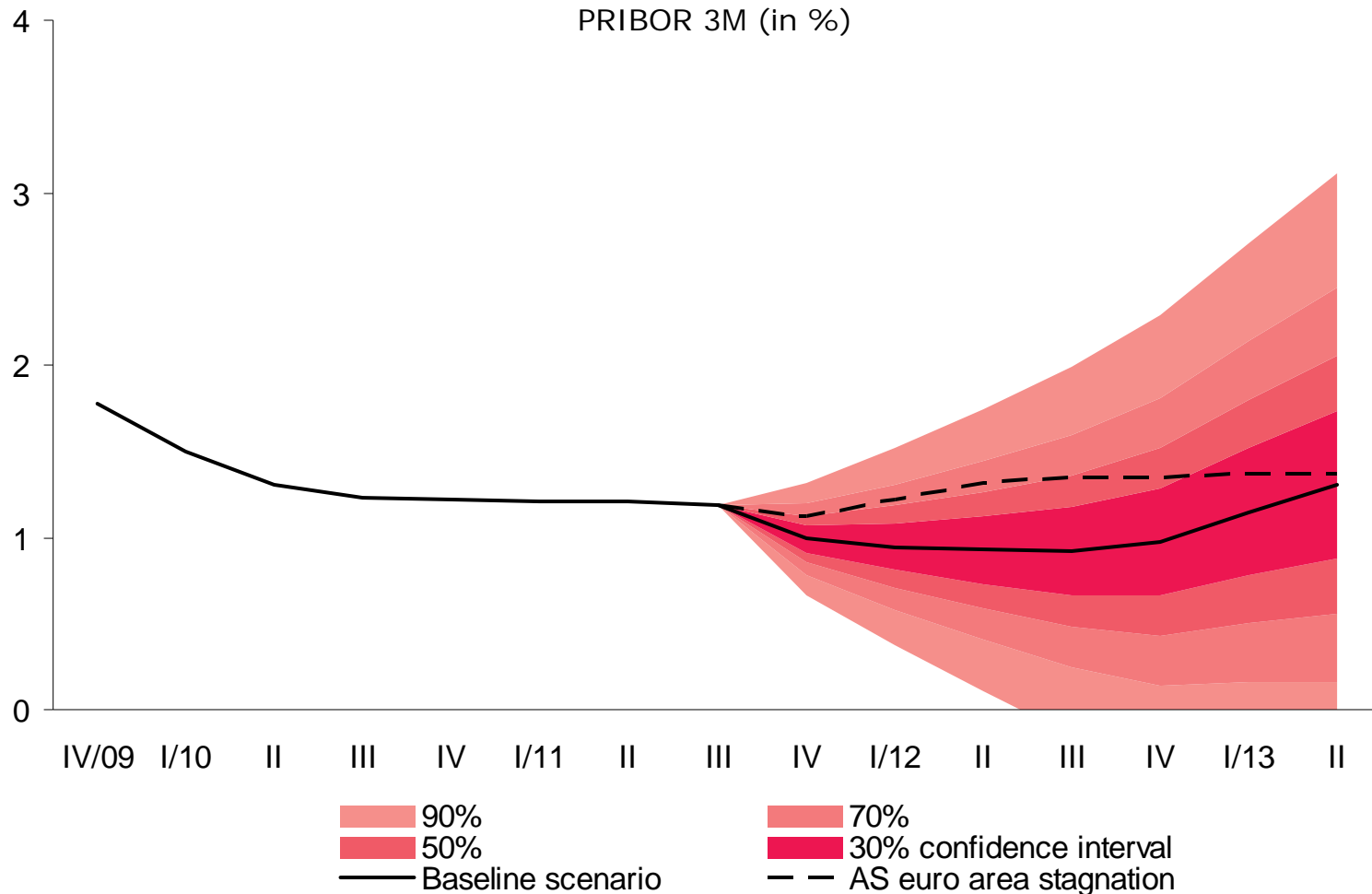
Nominal wage growth (y/y, in %, s.a.)



Household Consumption Growth (y/y, in %)

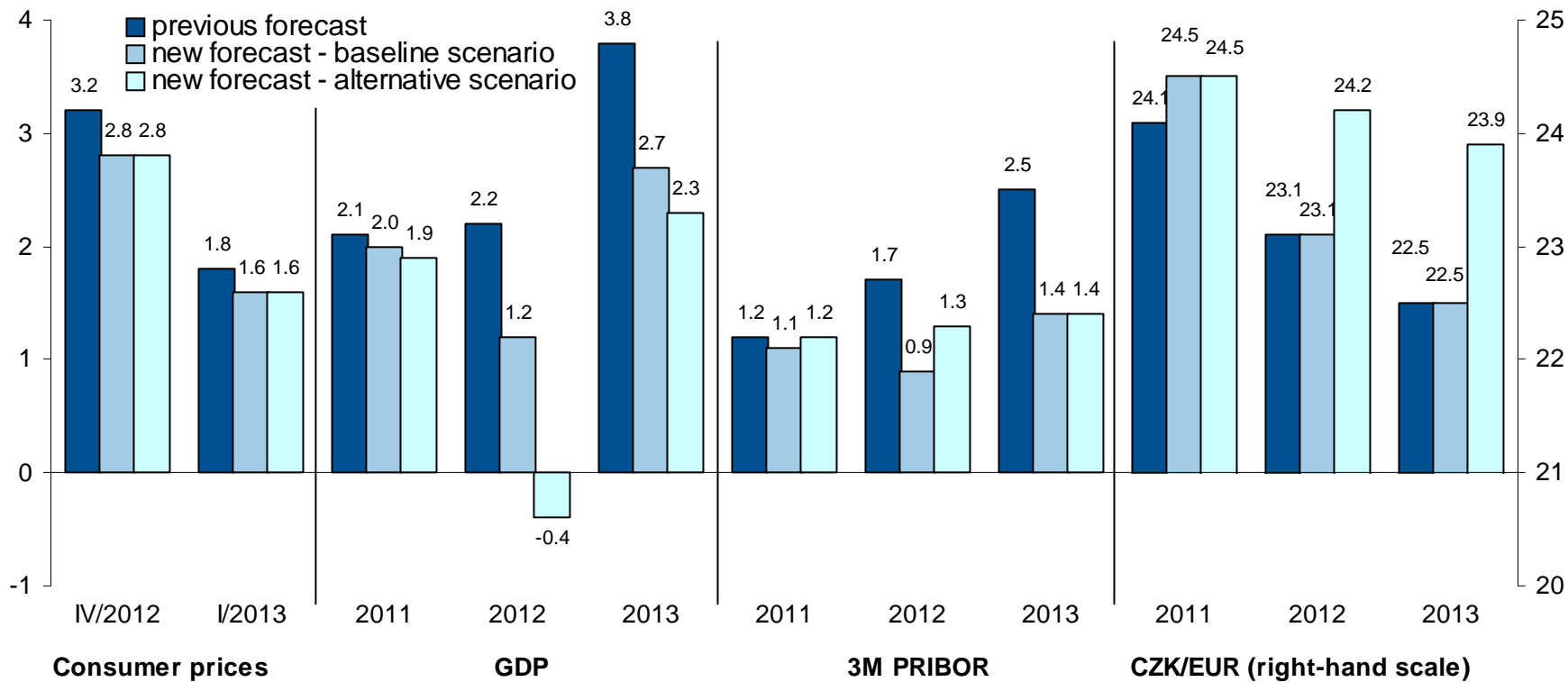


- The slowdown in export growth is more pronounced in the alternative.
- Domestic wages and consumption (+ investment) are affected, too.



- The more gradually appreciating exchange rate path is associated with a higher interest rate outlook (no decline at the start of the forecast horizon).

Summary Chart



Thank you for your attention

www.cnb.cz

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